SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 187

ARTHUR M. BROWN, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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[1*] DOCKET No. 35,305.

ARTHUR M. BROWN

vs.

COMMISSIONER OF INT. REV.

APPEARANCES.

For Taxpayer: KENNETH N. LOGAN, C. P. A.
ARTHUR B. DUNNE, Esq.
For Commissioner: EUGENE MEACHAM, Esq.

DOCKET ENTRIES.

1928.

Feb. 20.—Petition received and filed. Taxpayer notified. (Fee paid.)

Feb. 21—Copy of petition served on General Counsel.

Apr. 20—Answer filed by G. C.

Apr. 23—Copy of answer served on taxpayer—Circuit Cal.

1930.

Mar. 11—Hearing set May 14, 1930, San Francisco, Cal.

May 5—Application for subpoena filed by taxpayer.

May 6—Subpoena duces tecum to R. H. Lucas issued. 5-6-30 Subpoena served.

May 14—Hearing had before Mr. Marquette on motion to consolidate with Dkts. 39,157

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*Page-number appearing at the top of page of original certified Transcript of Record.

1930.

and 43,432 for hearing and decision. Granted. Continued to 5-15-30. Briefs due 9-15-30.

Aug. 16—Transcript of hearing of May 14 and 15, 1930, filed.

Sept. 12—Motion for extension to Sept. 30, 1930, to file brief filed by taxpayer. 9-15-30 Granted to 9-30-30.

Sept. 12—Motion for extension to Sept. 25, 1930, to file brief filed by G. C. 9-15-30 Granted to 9-30-30.

Sept. 16—Brief filed by taxpayer. (20 copies rec'd 9-17-30.)

Sept. 22—Brief filed by G. C.

1931.

Mar. 11—Findings of fact and opinion rendered, John J. Marquette, Div. 1. Judgment will be entered under Rule 50.

Mar. 16—Motion for judgment filed by G. C.

Mar. 20—Hearing set Apr. 15, 1931, under Rule 50.

Apr. 15—Hearing had before Mr. Marquette on settlement under Rule 50. Referred to Mr. Marquette for order.

Apr. 25—Decision entered, John J. Marquette, Div. 1.

Aug. 27—Stipulation to consolidate in one appeal with Dkts. 39,157 and 43,432 filed.

Sept. 4—Supersedeas bond in the amt. of $40,775.04 approved and ordered filed.

Sept. 8—Petition for review to U. S. Cir. Ct. of

1931.

Ap. (9) with assignments of error filed by taxpayer.

Sept. 9.—Proof of service filed.

Nov. 4—Copy of order from U. S. Cir. Ct. of Ap. (9) extending time for 30 days to prepare evidence and transmit record filed. (To Dec. 7. 1931.)

Dec. 3—Copy of order from U. S. Cir. Ct. of Ap. (9) extending time for 30 days to prepare evidence and transmit record filed. (To Jan. 6, 1932.)

Dec. 16—Statement of evidence lodged.

1932.

Jan. 5—Proof of service filed.

Jan. 6—Copy of order from U. S. Cir. Ct. of Ap. (9) extending time for 30 days to prepare evidence and transmit record filed. (To Feb. 5, 1932.)

[2] Docket No. 35,305.

Jan. 6—Praecipe filed.

Jan. 6—Request to present statement on Jan. 18, 1932, filed.

Jan. 6—Notice of lodgment of statement and of hearing Jan. 18, 1932, filed.

Jan. 6—Affidavit of service of statement and above papers filed.

Jan. 9—Notice of change of hearing to Jan. 20, 1932.

Jan. 21—Statement of evidence approved and ordered filed.

1932.

Jan. 20—Hearing had before Mr. Arundell, Div. 7, on approval of statement of evidence—Commissioner has no objection—referred to Mr. Marquette for approval.

Feb. 5—Order entered extending time for transmission and delivery of record to March 5, 1932.

Mar. 5—Order entered extending time for transmission and delivery of record to April 5, 1932.

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[3] DOCKET No. 39,157.

ARTHUR M. BROWN

vs.

COMMISSIONER OF INT. REV.

APPEARANCES.

For Taxpayer: KENNETH N. LOGAN, C. P. A.
A. B. DUNNE, Esq.

For Commissioner: EUGENE MEACHAM, Esq.

DOCKET ENTRIES.

1928.

June 6—Petition received and filed. Taxpayer notified. (Fee paid.)

June 7—Copy of petition served on General Counsel.

Aug. 6—Answer filed by G. C.

1928.

Aug. 8—Copy of answer served on taxpayer—Cir. calendar.

Dec. 21—Stipulation as to deficiency filed.

1930.

Mar. 11—Hearing set May 14, 1930, at San Francisco, Cal.

May 5—Application for subpoena filed by taxpayer.

May 6—Subpoena issued—Robert H. Lucas.

May 14—Hearing had before J. J. Marquette, Div. 1, called on petitioner's motion to consolidate with Docket Nos. 35,305 and 43,432 Granted. Briefs due 9-15-30.

Aug. 16—Transcript of hearing May 14, 1930, filed.

Sept. 12—Motion for extension to Sept. 30, 1930, to file brief filed by taxpayer, 9-15-30 Granted to 9-30-30.

Sept. 12—Motion for extension to Sept. 25, 1930, to file brief filed by G. C. 9-15-30 Granted to 9-30-30.

Sept. 16—Brief filed by taxpayer. See 35,305.

Sept. 22—Brief filed by G. C.

1931.

Mar. 11—Findings of fact and opinion rendered, John J. Marquette, Div. 1. Judgment will be entered under Rule 50.

Mar. 16—Motion for judgment filed by G. C. See 35,305.

Mar. 20—Hearing set April 15, 1931, on settlement.

Apr. 15—Hearing had before Mr. Marquette, Div.

1931

1, on settlement Rule 50. Referred to Mr. Marquette.

Apr. 25—Decision entered, Div. 1.

Aug. 27—Stipulation to consolidate in one appeal with Dkts. 35,305 and 43,432 filed.

Sept. 4—Supersedeas bond in the amount of $40,775.04 approved and ordered filed.

Sept. 8—Petition for review to U. S. Cir. Ct. of Ap. (9) with assignments of error filed by taxpayer.

Sept. 9—Proof of service filed.

Nov. 4—Copy of order from U. S. Cir. Ct. of Ap. (9) extending time for 30 days to prepare statement and transmit record filed.

Dec. 3—Copy of order from U. S. Cir. Ct. of Ap. (9) extending time for 30 days to prepare statement and transmit record filed.

Dec. 16—Statement of evidence lodged.

[4] Docket No. 39,157.

1932.

Jan. 5—Proof of service of statement filed.

Jan. 6—Copy of order from U. S. Cir. Ct. of Ap. (9) extending time for 30 days to prepare statement and transmit record filed.

Jan. 6—Praecipe filed.

Jan. 6—Request to present statement to member for approval on Jan. 18, 1932, filed.

1932.

Jan. 6—Notice of lodgment of statement and of hearing on Jan. 18, 1932, filed.

Jan. 6—Affidavit of service of statement and above papers filed.

Jan. 9—Notice changing hearing date to Jan. 20, 1932.

Jan. 21—Statement of evidence approved and ordered filed.

Jan. 20—Hearing had before Mr. Arundell, Div. 7, on approval of statement of evidence—Commissioner has no objection—referred to Mr. Marquette for approval.

Feb. 5—Order entered extending time for transmission and delivery of record to March 5, 1932.

Mar. 5—Order entered extending time for transmission and delivery of record to April 5, 1932.

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[5] DOCKET No. 43,432.

ARTHUR M. BROWN

vs.

COMMISSIONER OF INT. REV.

APPEARANCES.

For Taxpayer: KENNETH N. LOGAN, C. P. A.
ARTHUR B. DUNNE, Esq.

For Commissioner: EUGENE MEACHAM, Esq.

DOCKET ENTRIES.

1929.

Apr. 1—Petition received and filed. Taxpayer notified. (Fee paid.)

Apr. 2—Copy of petition served on General Counsel.

May 31—Answer filed by G. C.

June 3—Copy served on taxpayer—Cir. Cal.

1930.

Mar. 11—Hearing set May 14, 1930, at San Francisco, California.

May 5—Application for subpoena filed by taxpayer.

May 6—Subpoena issued—duces tecum—Robt. H. Lucas.

May 14—Hearing had before J. J. Marquette, Div. 1. Called on petitioner's motion to consolidate with 35,305 and 35,157 for hearing and decision. Granted. Briefs due 9–15–30.

Aug. 16—Transcript of hearing May 14 and 15 filed.

Sept. 12—Motion for extension to Sept. 30, 1930, to file briefs filed by taxpayer. 9–15–30 granted to 9–30–30.

Sept. 12—Motion for extension to Sept 25, 1930, to file brief filed by G. C. 9–15–30 Granted to 9–30–30.

Sept. 16—Brief filed by taxpayer.

Sept. 20—Brief filed by G. C.

1931.

Mar. 11—Findings of fact and opinion rendered, John J. Marquette, Div. 1. Judgment will be entered under Rule 50.

Mar. 16—Motion for judgment filed by G. C.

Mar. 20—Hearing set April 15, 1931, on settlement.

Apr. 15—Hearing had before Mr. Marquette, Div. 1 on settlement rule 50. Assigned to Mr. Marquette, Div. 1.

Apr. 25—Decision entered, Div. 1.

Aug. 27—Stipulation to consolidate on one appeal with Dkts. 35,305 and 39,157 filed.

Sept. 4—Supersedeas bond in the amount of $40,775.04, approved and ordered filed.

Sept. 8—Petition for review to U. S. Cir. Ct. of Appeals (9) with assignments or error, filed by taxpayer.

Sept. 9—Proof of service filed.

Nov. 4—Copy of order from U. S. Cir. Ct. of Ap. (9) extending time for 30 days to prepare statement and transmit record filed.

Dec. 3—Copy of order from U. S. Cir. Ct. of Ap. (9) extending time for 30 days to prepare statement and transmit record filed.

Dec. 16—Statement of evidence lodged.

[6] Docket No. 43,432.

1932.

Jan. 5—Proof of service of statement filed.

Jan. 6—Copy of order from U. S. Cir. Ct. of Ap. (9) extending time for 30 days to pre-

1932.

pare statement and transmit record filed.

Jan. 6—Praecipe filed.

Jan. 6—Request to present statement of evidence on January 18, 1932, filed.

Jan. 6—Notice of lodgment of statement and of hearing on January 18, 1932, filed.

Jan. 6—Affidavit of service of statement and above papers filed.

Jan. 9—Notice changing hearing date from Jan. 18, 1932, to Jan. 20, 1932.

Jan. 21—Statement of evidence approved and ordered filed.

Jan. 20—Hearing had before Mr. Arundell on approval of statement of evidence; respondent has no objection; referred to Mr. Marquette for approval.

Feb. 5—Order entered extending time for transmission and delivery of record to March 5, 1932.

Mar. 5—Order entered extending time for transmission and delivery of record to April 5, 1932.

[7] Filed Feb. 20, 1928.

United States Board of Tax Appeals.

DOCKET No. 35,305.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above-named taxpayer and petitioner hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter IT:FAR:B-2 LCT-60D, dated December 22, 1927, and as a basis of his appeal sets forth the following:

1. The taxpayer is a resident of the State of California and was doing business under the fictitious name of Edward Brown & Sons, with his principal office at 200 Bush Street, San Francisco, California.

2. The deficiency letter (copy of which is attached) was mailed to the taxpayer on December 22, 1927, and states a deficiency of $17,923.03.

3. The tax in controversy is income tax for the calendar year 1923, and is more than $10,000.00, to wit—$17,923.03.

4. The determination of the tax contained in said deficiency letter is based upon the following errors:

a. The Commissioner disallows as a deduction from taxable income a charge, made by the taxpayer, of $52,971.96, representing a reduction of overriding commission income to take care of return commissions.

b. The Commissioner disallowed the deduction because he claimed that it set up a reserve for return commissions, and that while such a reserve is allowed by special statutory provision for insurance companies, the business of the taxpayer is not that of an insurance company and the taxpayer is therefore not entitled to the same provisions.

[8] c. He also disallows as a deduction from the net taxable income to be reported by the taxpayer from the General Insurance Agency business the payment made by the business of $3,000.00 to Edith H. Halton.

5. The facts upon which the taxpayer relies as the basis of his appeal are as follows:

a. The business of the taxpayer was that of a General Insurance Agency representing several Insurance Companies on the Pacific Coast and in the Orient. It was a joint venture between himself and Mrs. Edith H. Halton and commenced operations on August 1, 1922. Mrs. Halton's interest being limited to a fixed annual payment of $3,000.00; the business was in fact virtually that of an individual.

Under the terms of his several contracts with the Insurance Companies the Agency was to receive as part of its revenue certain percentages of the premiums on insurance policies written in its territory, to accrue to it in consideration for its representation

of the several insurance companies in the territory assigned to it.

The duties to be performed by him as general agent were practically all duties which would be performed by the insurance companies themselves if they were operating directly in the territory. They included, for example—

1—Obtaining business,

2—Writing of policies and applying correct Standard Forms,

3—Computing of premiums to be paid Insurance Companies,

4—Computing commissions to be paid to brokers,

5—Computing overriding commissions to be paid their Agency,

6—Collection of premiums and remittance to Home Office of Insurance Companies,

7—Placing of reinsurance,

8—Preparation and correction of Map Books for determination of risks to be placed,

9—Adjustment of losses,

10—Settlement thereof with insured,

11—Preparation of cancellation of policies, computing and repayment of return premiums,

12—Computing and adjustment of return commissions and overriding commissions,

13—Issuing of covering notes, "riders" to policies for change in original policies, etc.,

14—Preparation of daily, monthly and yearly Borderaux to Home Offices for new business, reinsurance, cancellations, losses, premium income and settlement sheets,

15—Purchasing of forms, policies, etc., for use of Insurance Companies,

16—Preparation of Municipal, State and Federal reports for Insurance Companies,

[9] and many other duties too numerous to relate in a concise statement of facts.

As stated above, a measure for the payment of these continuous services was a percentage of the premiums written in its territory. This accrual of income is termed "overriding commissions."

Under the terms of the contracts with the several insurance companies the overriding commissions were subject to all of the conditions to which the premiums of an insurance company were subjected. These conditions were:

(1) The premiums were not collected by the General Agent until sixty days after the policy was written. The commissions were, therefore, not credited to the General Agent until that time had elapsed.

(2) An insurance policy being an instrument based on time, the measure of premium income and overriding commission income were likewise based on time. That is, if a policy is written for one year's duration and bears a premium of, say, $100.00, the same face value of policy, if written for three years, would carry a premium of approximately two times the one year premium, or, say, $200.00, and a five-year policy three times, or, say, $300.00; and the overriding commission, if the commission were, say, ten per cent, which would be ultimately earned by the General Agency, if the policy

remained in force throughout its full term, would be in the first case $10.00, in the second $20.00 and the third $30.00.

(3) Subject to the sixty days grace period, premiums on policies were paid in advance. These payments were subject to refund upon cancellation of the policy, as shown in item 4 below, and constituted a direct liability of the insurance company in the proportion that the unexpired term of the policy bore to the total life of the policy. The law, recognizing this liability, required the insurance companies to set up the liability on their balance sheets and to withhold from premium income all unearned premiums, and prescribed the method to be followed in determining the amount. The same liability existed in the case of General Agents upon the receipt by them of overriding commissions, and the taxpayer, recognizing this liability, set up on his books a liability for the year 1923 of $52,971.96. In setting up this amount as a liability the taxpayer used as a basis, not the unexpired portion of the overriding commission deposit outlined for insurance companies in their treatment of insurance premiums, but only a liability for unexpired overriding commission deposits, which his previous experience as a general agent told him would surely have to be repaid to the insurance companies through actual cancellation of policies and the refund of overriding commissions as discussed in the next paragraph.

(4) Insurance policies, on which overriding commissions were paid, were subject to cancellation

at any time during the life of the policy, either at the request of the assured or the insuring company. Upon the cancellation of a policy the General Agent computed the amount of premium which had not expired (amount which had not been earned by the insuring company through failure of the policy [10] to run its full life) and made refund to the assured accordingly. He likewise computed the unexpired (unearned) overriding commission and refunded same to the insurance company.

It has been argued by the Commissioner, although not set forth in his deficiency letter of December 22, 1927,that the establishment of a liability for return overriding commissions due to cancellations, based upon previous experience of the ratio of cancellations to total premiums written, cannot be allowed, as that method does not provide an accurate means of determining the exact amount of the liability. If there is any merit in his contention, the taxpayer claims the right to set up as a liability as at the close of the year 1923 the full unexpired deposit on overriding commissions, because until the actual lapse of time has taken place the total unearned overriding commission is subject to refund, and therefore constitutes a tangible liability of the General Agency.

b. The taxpayer claims that the right to set up a liability to take care of obligations incurred by him as a General Agent and to withhold from taxable income in any year that income which had not accrued to him unconditionally was not dependent upon the establishment of the fact that the General

Agent was conducting an insurance business, and so came under the special statutory provisions governing insurance companies and their establishment of a so-called reserve, which we believe is a misnomer. He claims that the Revenue Act required all business enterprises keeping their books on the accrual basis to report in the taxable year in question only such income as had actually been earned by them in that year and to carry over to subsequent years all items of income and expense which should be properly accounted for as of a different period. He further claims that, in order to truly reflect his financial status, he must establish on his books liabilities which existed and for which he was legally liable.

The books of the taxpayer were kept on the accrual basis, which fact has been acknowledged by the Commissioner.

c. The $3,000.00 paid to Mrs. Edith H. Halton, sister of the taxpayer, which was disallowed as a deduction by the Commissioner, has already been the subject of an appeal to your honorable Board for the years 1920 and 1921, heard on July 6–7, 1927 (the year 1922 reflected a refund and therefore did not come under the jurisdiction of the Board of Tax Appeals), for which years a decision was rendered in favor of the taxpayer following and agreement by stipulation with the Solicitor to the Treasury Department. This deduction has been continuous yearly from 1904, following the death of taxpayer's father, from whom the taxpayer and his brother inherited the business of Edward Brown

& Sons. The yearly payment to the sisters of taxpayer constituted the sisters' participation in the business of Edward Brown & Sons. Such deduction was originally based upon a percentage of the earnings of the business, but at the request of the sisters, who wished to be assured of the amount to be received by them, it was changed to a fixed sum of $3,000.00 per annum, being their proportion of the then estimated average earnings.

[11] The interest of Mrs. Halton in the business left by Mr. Edward Brown was carried into the joint venture established by Mr. Arthur M. Brown and Mrs. Edith H. Halton, upon the dissolution of the partnership on July 31, 1922, by the payment to her of the same stipulated amount, i. e., $3,000.00 per annum, as she was receiving in prior years.

6. The taxpayer in support of his appeal relied upon the following propositions of law:

a. (1) Section 212–b of the Revenue Act of 1921, which defines net income of a taxpayer and states in part that the net income to be reported must clearly reflect the income.

(2) Article 23 of the Regulations 62 pertaining to Section 212, which defines the basis of computation. This article holds that "Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. A taxpayer is deemed to have received

items of gross income which have been credited to or set apart for him without restriction." (Underlining not part of quotation.)

b. Article 1507 of the regulations covering Section 2 defines joint adventure. Office Decision 425, 2 C. B. 198, states: "The management of property held by a number of brothers and sisters as tenants in common under the father's will, and the distribution of income therefrom, by one of the brothers under an oral agreement, does not constitute a legal trust. Each beneficiary should file a separate return, including therein his share of the income from the property and claiming a proportionate share of any allowable deductions."

WHEREFORE, the taxpayer respectfully prays that this Board may hear and determine its appeal.

KENNETH N. LOGAN,
Certified Public Accountant,
Accountant for Taxpayer.

KENNETH N. LOGAN,
1222 Balfour Building,
San Francisco, California.

[12] Arthur M. Brown, being duly sworn, says that he is the taxpayer in the foregoing petition; that he has read the said petition and is familiar with the statements therein contained, and that the facts therein stated are true, except such facts as are stated to be upon information and belief, and those facts he believes to be true.

ARTHUR M. BROWN.

Subscribed and sworn to before me this 14th day of February, 1928.

[Seal] LULU P. LOVELAND,
Notary Public in and for the City and County of San Francisco, State of California.

[13] COPY.

December 22, 1927.

IT:FAR:B-2.
LCT-60D.

Mr. Arthur M. Brown,
200 Bush Street,
San Francisco, California.

Sir:

The determination of your income tax liability for the year 1923, discloses a deficiency of $17,923.03, as shown by the attached statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on

such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:FAR:B-2-LCT-60D. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,
D. H. BLAIR,
Commissioner.

Inclosures:
Statement.
Form A.
Form 882 SDG-2.

[14] COPY.

STATEMENT.

IT:FAR:B-2.
LCT-60D.

Dec. 22, 1927.

In re: Mr. Arthur M. Brown,
200 Bush Street,
San Francisco, California.

Year.	Deficiency in Tax.
1923.	$17,923.03.

The report of the Internal Revenue Agent in

Charge at San Francisco, California, transmitted to this office under date of July 23, 1927, has been reviewed with the following exception:

The deduction of $3,185.15 for Christmas Gifts to Employees has been allowed. This deduction was an ordinary and necessary business expense of the concern when it was made and it was recommended by the Internal Revenue Agent in Charge that the amount be allowed.

The revenue agent has been sustained in regard to the disallowance of the deduction of $52,971.96, representing a reserve for return commissions. Insurance companies are entitled under the Law to set up such reserves, and you contend that being in the insurance business you would be entitled to the same method of computing income. In this connection, you are advised that the provisions of the Law governing insurance companies for the purpose of setting up reserves is statutory. Your business is not an insurance company inasmuch as you are acting as an agent in writing insurance policies for which you receive a commission. It, therefore, cannot be held that you are entitled to the same provisions as an insurance company.

It has been held by this office that the deduction of $3,000.00 paid to Edith H. Holton, is a capital expenditure and is not deductible from income. It has also been held by this office that the deduction for a payment to the Industrial Association of San Francisco is not allowable.

It is noted that all other adjustments as made by the Revenue Agent have been conceded by you.

Mr. Arthur M. Brown. Statement.

Net Income originally reported.....			$35,563.20
Salaries reported.....		$18,000.00	
As adjusted.....		21,600.00	
			3,600.00
Income from business reported.....	$15,590.75		
As adjusted.....	73,668.11		
			58,077.36
Other deductions as claimed.....	2,413.36		50.00

As adjusted	2,363.36		
Total income as adjusted		97,290.56	
Dividends and exemption		6,479.20	
Amount subject to normal tax		90,811.36	
Total tax			28,298.57
25% Reduction, Revenue Act of 1924			7,074.64
Net tax assessable			21,223.93
Tax assessed	4,401.20		
25% Reduction, Revenue Act of 1924	1,100.30		3,300.90
Deficiency			17,923.03

Payment of the tax should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

SDG–2.

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[16] Filed Apr. 20, 1928. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 35,305.

BROWN, ARTHUR M.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ANSWER.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1. Admits the allegations contained in Paragraph 1 of the petition.

2. Admits the allegations contained in Paragraph 2 of the petition.

3. Admits the allegations contained in Paragraph 3 of the petition.

4. Denies that the Commissioner erred as alleged

in subdivisions 4(a), 4(b) and 4(c) of Paragraph 4 of the petition.

5. Denies generally and specifically each and every allegation set forth in taxpayer's petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the taxpayer's appeal be denied.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
PHILIP M. CLARK,
Special Attorney,
Bureau of Internal Revenue.

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[17] Filed June 6, 1928.

May 22, 1928.

United States Board of Tax Appeals.

DOCKET No. 39,157.

ARTHUR M. BROWN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION.

The above-named taxpayer and petitioner hereby appeals from the determination of Commissioner of Internal Revenue set forth in his deficiency letter dated April 28, 1928, Reference IT:FAR:B-12

RRP–60 D, and as basis of his appeal sets forth the following:

1. The taxpayer is a resident of the State of California and was doing business as a partner in Edward Brown & Sons, with its principal office at 200 Bush Street, San Francisco, California.

2. The deficiency letter, copy of which is attached, was mailed to the taxpayer on April 28, 1928, and states a deficiency of $1,520.19.

3. The tax in controversy is income tax for the calendar year 1925 and is less than $10,000.00, to wit, $1,520.19.

4. The taxpayer admits all the changes made by the Commissioner to his original return, except in the matter of increase of partnership (Edward Brown & Sons) income for 1925, in the amount of $3,292.98, being part of the Commissioner's addition to partnership income of $7,491.80.

5. The determination of the tax contained in said deficiency letter is based upon the following errors:

[18] (a) The Commissioner disallows as a deduction from taxable income a charge made on the books of the partnership of Edward Brown & Sons, representing a reduction of overriding commission income to take care of commissions which would have to be returned. In 1925 the net amount so disallowed amounted to $3,292.98.

(b) The Commissioner disallowed this deduction in line with his ruling for 1923, which has become a matter of appeal to your honorable board under docket number 35,305, and while not now

so distinctly stating, bases his decision that such charge is a reserve set up for return commission, and that while such a reserve is allowed by special statutory provision for Insurance Companies, the business of the taxpayer is not that of an Insurance Company, and the taxpayer is, therefore, not entitled to the same provisions.

6. The facts upon which the taxpayer relies as the basis of his appeal are as follows:

(a) The taxpayer is a partner in Edward Brown & Sons, holding a 19/24 interest therein.

(b) The business of Edward Brown & Sons is that of a General Insurance Agency representing several Insurance Companies on the Pacific Coast and in the Orient.

Under the terms of the several contracts with the Insurance Companies the Agency was to receive as part of its revenue certain percentages of the premiums on insurance policies written in its territory, to accrue to it in consideration for its representation of the several insurance companies in the territory assigned to it.

The duties to be performed by the partnership as General Agents were practically all duties which would be performed by the insurance companies themselves if they were operating directly in the territory. They included, for example—

1—Obtaining business,

2—Writing of policies and applying correct Standard Forms,

3—Computing of premiums to be paid Insurance Companies,

4—Computing commissions to be paid to brokers,
5—Computing overriding commissions to be paid their Agency,
6—Collection of premiums and remittance to Home Office of Insurance Companies,
7—Placing of reinsurance,
8—Preparation and correction of Map Books for determination of risks to be placed,
9—Adjustment of losses,
10—Settlement thereof with insured,
11—Preparation of cancellation of policies, computing and repayment of return premiums,
12—Computing and adjustment of return commissions and overriding commissions,
13—Issuing of covering notes, "riders" to policies for change in original policies, etc.,
[19] 14—Preparation of daily, monthly and yearly Borderaux to Home Offices for new business, reinsurance, cancellations, losses, premium income and settlement sheets,
15—Purchasing of forms, policies, etc., for use of Insurance Companies,
16—Preparation of Municipal, State and Federal reports for Insurance Companies,

and many other duties too numerous to relate in a concise statement of facts.

As stated above, a measure for the payment of these continuous services was a percentage of the premiums written in its territory. This accrual of income is termed "overriding commissions."

Under the terms of the contracts with the several insurance companies the overriding commis-

sions were subject to all of the conditions to which the premiums of an insurance company were subjected. These conditions were:

(1) The premiums were not collected by the General Agents until sixty days after the policy was written. The commissions were, therefore, not credited to the General Agents until that time had elapsed.

(2) An insurance policy being an instrument based on time, the measure of premium income and overriding commission income were likewise based on time. That is, if a policy is written for one year's duration and bears a premium of, say, $100.00, the same face value of policy, if written for three years, would carry a premium of approximately two times the one year premium, or, say, $200.00, and a five-year policy three times, or, say, $300.00; and the overriding commission, if the commission were, say, ten per cent, which would be ultimately earned by the General Agency, presuming the policy remained in force throughout its full term, would be in the first case $10.00, in the second $20.00 and the third $30.00.

(3) Subject to the sixty days' grace period, premiums on policies were paid in advance. These payments were subject to refund upon cancellation of the policy, as shown in Item 4 below, and constituted a direct liability of the insurance company in the proportion that the unexpired term of the policy bore to the total life of the policy. The law, recognizing this liability, required the insurance companies to set up the liability on their balance

sheets and to withhold from premium income all unearned premiums, and prescribed the method to be followed in determining the amount. The same liability existed in the case of General Agents upon the receipt by them of overriding commissions, and the Partnership, recognizing this liability, set up on their books a liability for the year 1925 of an amount to take care of estimated cancellations upon commissions earned on policies written. In setting up this amount as a liability they used as a basis, not the unexpired portion of the overriding commission deposit for insurance companies in their treatment of insurance premiums, but only a liability [20] for unexpired overriding commission deposits, which previous experience as general agents indicated would surely have to be repaid to the insurance companies through actual cancellation of policies and the refund of overriding commissions as discussed in the next paragraph.

(4) Insurance policies, on which overriding commissions were paid, were subject to cancellation at any time during the life of the policy, either at the request of the assured or the insuring company. Upon the cancellation of a policy the General Agent computed the amount of the premium which had not expired (amount which had not been earned by the insuring company through failure of the policy to run its full life) and made refund to the assured accordingly. They likewise computed the unexpired (unearned) overriding commission and refunded same to the insurance company.

It has been argued by the Commissioner, although

not set forth in his deficiency letter of April 28, 1928, that the establishment of a liability for return overriding commissions due to cancellations, based upon previous experience of the ratio of cancellations to total premiums written, cannot be allowed, as that method does not provide an accurate means of determining the exact amount of the liability. If there be any merit in his contention, the taxpayer claims the right to set up as a liability the full unexpired deposit on overriding commissions, because until the actual lapse of time has taken place the total unearned overriding commission is subject to refund, and therefore constitutes a tangible liability of the General Agency. In other words, if denied the right to compute the amount of probable cancellations based upon past experience, the taxpayer claims the right to determine his actual earned income from commissions set up in the manner provided by law for insurance companies upon the amount of earned premiums calculated upon premiums received.

(c) The taxpayer claims that the right to set up a liability to take care of obligations incurred by the partnership as General Agents and to withhold from taxable income in any year that income which had not accrued to it unconditionally was not dependent upon the establishment of the fact that the General Agents were conducting an insurance business, and so came under the special statutory provisions governing insurance companies and their establishment of a so-called reserve, which we believe is a misnomer, but he does claim that

the Revenue Act required all business enterprises keeping their books on the accrual basis to report in the taxable year in question only such income as had actually been earned by them in that year and to carry over to subsequent years all items of income and expense which should be properly accounted for as of a different period. He further claims, that in order to truly reflect the partnership's financial status, it must establish on its books liabilities which existed and for which it was legally liable, or in lieu thereof only report such income as has accrued to it unconditionally and without restriction.

The books of the partnership were kept on the accrual basis, which fact has been acknowledged by the Commissioner.

[21] 7. The taxpayer in support of his appeal relies upon the following propositions of law:

a. (1) Section 212–b of the Revenue Act of 1921, which defines net income of a taxpayer and states in part that the net income to be reported must clearly reflect the income.

(2) Article 23 of the Regulations 62 pertaining to section 212, which defines the basis of computation. This article holds that "Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. A taxpayer is deemed to have received items of gross

income which have been credited to or set apart for him without restriction." (Underlining not part of quotation.)

WHEREFORE, the taxpayer respectfully prays that this Board may hear and determine his appeal.

KENNETH N. LOGAN,
Certified Public Accountant,
Accountant for Taxpayer.

KENNETH N. LOGAN,
1222 Balfour Building,
San Francisco, California.

[22] Arthur M. Brown, being duly sworn, says that he is the taxpayer in the foregoing petition; that he has read the said petition and is familiar with the statements therein contained, and that the facts therein stated are true, except such facts as are stated to be upon information and belief, and those facts he believes to be true.

ARTHUR M. BROWN.

Subscribed and sworn to before me this 31 day of May, 1928.

[Seal] LULU P. LOVELAND,
Notary Public in and for the City and County of San Francisco, State of California.

[23] STATEMENT.

Apr. 28, 1928.

IT:FAR:B-12.
RRP:60D.

In re: Mr. Arthur Brown,
200 Bush Street,
San Francisco, California.

Year.	Deficiency.
1925.	$1,520.19.

Reference is made to the report of the Internal Revenue Agent in Charge at San Francisco, California, covering an investigation of your income tax liability for the year 1925, and to your letter dated April 16, 1928.

Relative to your request that the adjustment of additional income from the partnership of Edward Brown & Sons be held in abeyance pending the decision by the Board of Tax Appeals of your appeal for the year 1923, you are advised that it is not the policy of this office to grant such requests.

Your proportionate share of the donations disallowed to the partnership has been allowed as a deduction in determining your taxable income.

Net income reported on the return.....			$42,689.60
Add:			
1.	Partnership income	$7,491.80	
2.	Partnership dividends..	227.75	
3.	Stock assessment	812.50	8,532.05
			$51,221.65

Deduct:		
4. Stock loss	$ 50.00	
5. Liberty Bond Interest	10.63	
6. Contributions	423.54	484.17
Adjusted net income		$50,737.48

Computation of Tax.

Adjusted net income		$50,737.48
Less:		
Dividends	$3,407.25	
Exemption	3,500.00	6,907.25
Income subject to normal tax		$43,830.23

Copy.

[24] Mr. Arthur M. Brown. Statement.

Tax at 1½% on $ 4,000.00	$ 60.00
Tax at 3% on $ 4,000.00	120.00
Tax at 5% on $35,830.23	1,791.51
Surtax	3,075.87
Total	$5,047.38
Less:	
Earned income credit	$30.18
Tax paid at source	26.90 57.08
Net tax assessable	$4,990.30
Previously assessed	3,470.11
Deficiency	$1,520.19

Explanation of Changes.

1 and 2. The income to be reported from the

partnership has been adjusted in accordance with the changes made in the partnership income.

3. The assessments paid on Robbers Roost stock represent capital expenditures and should be added to the cost of the stock.

4. A loss of $50.00 from the sale of Chicago Northern stock was not claimed as a deduction on your return.

5. Nontaxable Liberty Bond interest was included as income.

6. Contributions have been increased by your proportionate share of those made through the partnership.

Payment of the deficiency in tax should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

Copy.

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[25] Filed Aug. 6, 1928. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 39,157.

BROWN, ARTHUR M.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ANSWER.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1. Admits the allegations contained in Paragraph 1 of the petition.

2. Admits the allegations contained in Paragraph 2 of the petition.

3. Admits the allegations contained in Paragraph 3 of the petition.

4. Denies that the Commissioner committed err*ed* in the matter of increase of partnership (Edward Brown & Sons) income for 1925, in the amount of $3,292.98.

5. Denies that the Commissioner erred as alleged in subdivisions 5(a) and 5(b) of Paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation set forth in taxpayer's petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. CHAREST.
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
PHILIP M. CLARK,
Special Attorney,
Bureau of Internal Revenue.

[26] Filed April 1, 1929.

March 21, 1929.

United States Board of Tax Appeals.

DOCKET No. 43,432.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above-named taxpayer and petitioner hereby appeals from the determination of Commissioner of Internal Revenue set forth in his deficiency letter dated February 7, 1929, Reference IT:AR:B–1 FMA–6OD, and as a basis of his appeal sets forth the following:

1. The taxpayer is a resident of the State of California and was doing business as a partner in Edward Brown & Sons, with its principal office at 200 Bush Street, San Francisco, California.

2. The deficiency letter, copy of which is attached, was mailed to the taxpayer on February 7, 1929, and states a deficiency of $944.30.

3. The tax in controversy is income tax for the calendar year 1926 and is less than $10,000.00, to wit, $944.30.

4. The taxpayer admits all the changes made by the Commissioner to his original return, except in the matter of increase of partnership (Edward

Brown & Sons) income for 1926, in the amount of $1,947.77, being part of the Commissioner's addition to the partnership income of $4,330.05.

5. The determination of the tax contained in said deficiency letter is based upon the following errors:

[27] (a) The Commissioner disallows as a deduction from taxable income a charge made on the books of the partnership of Edward Brown & Sons, representing a reduction of overriding commission income to take care of commissions which would have to be returned. In 1926 the net amount so disallowed amounted to $1,947.77.

(b) The Commissioner disallowed this deduction in line with his ruling for 1923, which has become a matter of appeal to your honorable board under Docket No. 35,305, and while not now so distinctly stating, bases his decision that such charge is a reserve set up for return commission, and that while such a reserve is allowed by special statutory provision for Insurance Companies, the business of the taxpayer is not that of an Insurance Company, and the taxpayer is, therefore, not entitled to the same provisions.

6. The facts upon which the taxpayer relies as the basis of his appeal are as follows:

(a) The taxpayer is a partner in Edward Brown & Sons, holding a 75% interest therein.

(b) The business of Edward Brown & Sons is that of a General Insurance Agency representing several Insurance Companies on the Pacific Coast and in the Orient.

Under the terms of the several contracts with the Insurance Companies the Agency was to receive as part of its revenue certain percentages of the premiums on insurance policies written in its territory, to accrue to it in consideration for its representation of the several insurance companies in the territory assigned to it.

The duties to be performed by the partnership as General Agents were practically all duties which would be performed by the insurance companies themselves if they were operating directly in the territory. They included, for example—

1—Obtaining business,

2—Writing of policies and applying correct Standard Forms,

3—Computing of premiums to be paid Insurance Companies,

4—Computing commissions to be paid to brokers,

5—Computing overriding commissions to be paid their Agency,

6—Collection of premiums and remittance to Home Office of Insurance Companies,

7—Placing of reinsurance,

8—Preparation and correction of Map Books for determination of risks to be placed,

9—Adjustment of losses,

10—Settlement thereof with insured,

11—Preparation of cancellation of policies, computing and repayment of return premiums,

12—Computing and adjustment of return commissions and overriding commissions,

[28] 13—Issuing of covering notes, "riders" to policies for change in original policies, etc.
14—Preparation of daily, monthly and yearly Borderaux to Home Offices for new business, reinsurance, cancellations, losses, premium income and settlement sheets,
15—Purchasing of forms, policies, etc., for use of Insurance Companies,
16—Preparation of Municipal, State and Federal reports for Insurance Companies,
and many other duties too numerous to relate in a concise statement of facts.

As stated above, a measure for the payment of these continuous services was a percentage of the premiums written in its territory. This accrual of income is termed "overriding commissions."

Under the terms of the contracts with the several insurance companies the overriding commissions were subject to all of the conditions to which the premiums of an insurance company were subjected. These conditions were:

(1) The premiums were not collected by the General Agents until sixty days after the policy was written. The commissions were, therefore, not credited to the General Agents until that time had elapsed.

(2) An insurance policy being an instrument based on time, the measure of premium income and overriding commission income were likewise based on time. That is, if a policy is written for one year's duration and bears a premium of, say $100.00, the same face value of policy, if written for three years, would carry a premium of approximately

two times the one year premium, or, say, $200.00, and a five year policy three times, or, say, $300.00; and the overriding commission, if the commission were, say, ten per cent, which would be ultimately earned by the General Agency, presuming the policy remained in force throughout its full term, would be in the first case $10.00, in the second $20.00 and the third $30.00.

(3) Subject to the sixty days' grace period, premiums on policies were paid in advance. These payments were subject to refund upon cancellation of the policy, as shown in Item 4 below, and constituted a direct liability of the insurance company in the proportion that the unexpired term of the policy bore to the total life of the policy. The law, recognizing this liability, required the insurance companies to set up the liability on their balance sheets and to withhold from premium income all unearned premiums, and prescribed the method to be followed in determining the amount. The same liability existed in the case of General Agents upon the receipt by them of overriding commissions, and the Partnership, recognizing this liability, set up on their books a liability for the year 1926 of an amount to take care of estimated cancellations upon commissions earned on policies written. In setting up this amount as a liability they used as a basis, not the unexpired portion of the overriding commission deposit outlined [29] for insurance companies in their treatment of insurance premiums, but only a liability for unexpired overriding commission deposits, which previous experience as

general agents indicated would surely have to be repaid to the insurance companies through actual cancellation of policies and refund of overriding commissions as discussed in the next paragraph.

(4) Insurance policies, on which overriding commissions were paid, were subject to cancellation at any time during the life of the policy, either at the request of the assured or the insuring company. Upon the cancellation of a policy th General Agent computed the amount of the premium which had not expired (amount which had not been earned by the insuring company through failure of the policy to run its full life) and made refund to the assured accordingly. They likewise computed the unexpired (unearned) overriding commission and refunded same to the insurance company.

It has been argued by the Commissioner, although not set forth in his deficiency letter of February 7, 1929, that the establishment of a liability for return overriding commissions due to cancellations, based upon previous experience of the ratio of cancellations to total premiums written, cannot be allowed, as that method does not provide an accurate means of determining the exact amount of the liability. If there be any merit in his contention, the taxpayer claims the right to set up as a liability the full unexpired deposit on overriding commissions, because until the actual lapse of time has taken place the total unearned overriding commission is subject to refund, and therefore constitutes a tangible liability of the General Agency. In other words, if denied the right to compute the

amount of probable cancellations based upon past experience, the taxpayer claims the right to determine his actual earned income from commissions set up in the manner provided by law for insurance companies upon the amount of earned premiums calculated upon premiums received.

(c) The taxpayer claims that the right to set up a liability to take care of obligations incurred by the partnership as General Agents and to withhold from taxable income in any year that income which had not accrued to it unconditionally was not dependent upon the establishment of the fact that the General Agents were conducting an insurance business, and so came under the special statutory provisions governing insurance companies and their establishment of a so called reserve, which we believe is a misnomer, but he does claim that the Revenue Act required all business enterprises keeping their books on the accrual basis to report in the taxable year in question only such income as had actually been earned by them in that year and to carry over to subsequent years all items of income and expense which should be properly accounted for as of a different period. He further claims, that in order to truly reflect the partnership's financial status, it must establish on its books liabilities which existed and for which it was legally liable, or in lieu thereof only report such income as has accrued to it unconditionally and without restriction.

The books of the partnership were kept on the accrual basis, which fact has been acknowledged by the Commissioner.

[30] 7. The taxpayer in support of his appeal relies upon the following proposition of law:

a. (1) Section 212–b of the Revenue Act of 1921, which defines net income of a taxpayer and states in part that the net income to be reported must clearly reflect the income.

(2) Article 23 of the Regulations 62 pertaining to section 212, which defines the basis of computation. This article holds that "Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction." (Underlining not part of quotation.)

WHEREFORE, the taxpayer respectfully prays that this Board may hear and determine his appeal.

KENNETH N. LOGAN,
Certified Public Accountant,
Accountant for Taxpayer.

KENNETH N. LOGAN,
1222 Balfour Building,
San Francisco, California.

[31] Arthur M. Brown, being duly sworn, says that he is the taxpayer in the foregoing petition; that he has read the said petition and is familiar with the statements therein contained, and that the facts therein stated are true, except such facts as

are stated to be upon information and belief, and those facts he believes to be true.

ARTHUR M. BROWN.

Subscribed and sworn to before me this 25th day of March, 1929.

[Notarial Seal] KATHRYN E. STONE,
Notary Public in and for the City and County of San Francisco, State of California.

[32] STATEMENT.

Feb. 7, 1929.

IT:AR:B–1.
FMA–60D.

In re: Mr. Arthur M. Brown, Sr.,
200 Bush Street,
San Francisca, California.

Tax Liability.

Year.	Corrected Tax Liability.	Tax Previously Assessed.	Deficiency.
1926	$3,545.22	$2,600.92	$944.30

Reference is made to your letter dated December 17, 1928, in regard to the proposed deficiency in tax for the year 1926, as outlined in office letter addressed to you under date of December 3, 1928.

It appears that you have agreed with all the proposed changes in your net income for the year 1926 with the exception of your distributive share of the net income of the partnership of Edward Brown & Sons, in so far as such income is increased by the adjustment of $1,947.77 in the partnership's account, "Return Commissions." Inasmuch as a similar adjustment in the partnership income as re-

ported in your income tax return for the year 1923, is now pending before the United States Board of Tax Appeals, you request that further action with respect to this item for the year 1926 be deferred pending a decision of the United States Board of Tax Appeals in your 1923 case.

In this connection you are again advised that it is not the policy of this Bureau to withhold action on a taxpayer's return for a particular year pending the action of the United States Board of Tax Appeals on a petition filed with that body by the taxpayer for a redetermination of a deficiency proposed by the Income Tax Unit for another year or years.

Net income disclosed by return		$36,889.68
Add:		
1. Interest income	$ 1,514.00	
2. Partnership income	31,330.05	
3. Dividends increased	394.06	
4. Contributions decreased	18.75	
5. Assessments on stock disallowed	1,155.00	
6. Ranch expenses	242.39	
		34,654.25
		$71,543.93

Copy.

[33] Mr. Arthur M. Brown Senior.

Statement.

Brought forward	$71,543.93

Deduct:		
7. Salary from partnership	$27,000.00	
8. Interest income	1,296.81	
9. Profit from sale of stock rights	882.25	
10. Bad Debt Recoveries	242.39	29,421.45
Adjusted net income		$42,122.48
Less:		
Dividends	$ 3,019.79	
Personal exemption	3,500.00	6,519.79
Income subject to normal tax		$35,602.69

Computation of Tax.

Normal tax at 1½% on $4,000.00	60.00
Normal tax at 3% on 4,000.00	120.00
Normal tax at 5% on 27,602.69	1,380.13
Surtax on $42,122.48	2,033.47
Total tax	$ 3,593.60
Less:	
Earned income credit $ 18.10	
Tax paid at source 30.28	
	48.38
Tax liability stated on Form 866	$3,545.22
Less:	
Tax previously assessed	2,600.92
Proposed deficiency	$ 944.30

Explanation of Changes.

1. Interest received on tax-free covenant bonds has been found to be $1,514.00, whereas no amount was reported under Item 3 (a) of your return. However, it is disclosed that $1,296.81 of such interest was erroneously reported under Item 3 of your return. For further explanations see Change #8 below.

Copy.

[34] Mr. Arthur M. Brown, Senior.

Statement.

2. The adjustments in the net income of Edward Brown & Sons as set forth and explained in the revenue agent's report on this partnership, a copy of which was furnished the firm, have been reviewed and approved, with the exception that the payment of $2,200.00 to Mrs. E. Halton has been allowed as claimed on the partnership's return, Form 1065, filed for the year 1926. Therefore, your distributive share of the net income of this partnership has been decreased from $41,216.21, the amount disclosed by the Internal Revenue Agent, to $39,566.21. This reduction of $1,650.00 in partnership income represents your three-fourths share of the payment of $2,200.00 made by the partnership to Mrs. E. Halton.

3. Dividends received are $3,019.79, instead of $2,625.73, the amount reported on your return. The difference of $394.06 has been added to the income in accordance with Section 213 (a) of the Revenue Act of 1926.

4. Your three-fourths share of contributions of

$717.00 made through the partnership of Edward Brown & Sons is $537.75, instead of $556.50, the amount shown on your return. The difference of $18.75 has been added to the income.

5. Assessments on the capital stock of a corporation paid by its stockholders are held to constitute an addition to the cost of the stock and as such are not allowable as deductions from the gross income. This adjustment is in accordance with Article 292 of Regulations 69.

6. This adjustment is offset by the ranch income in the amount of $242.39 reported under Item 9 (a) of the return and which has been eliminated from income.

7. This item, representing salary from the partnership of Edward Brown and Sons, has been transferred to Line 4 of the return.

8. Interest of $1,296.81 received on tax-free covenant bonds has been included in adjustment #1 above.

9. This item represents the adjustment of the cost of stock rights, which you failed to claim as a deduction from the selling price of these assets.

10. See Explanation of Change #6 above.

Copy.

[35] Mr. Arthur M. Brown, Senior.

Statement.

The reduction in the earned income credit from $206.25, the amount reported on your return, to $18.10, is due to the fact that your earned net income is limited to 20% of the partnership income of $39,566.21, or $7,913.24. This adjustment is in

accordance with Section 209 (a) (1) of the Revenue Act of 1926, as interpreted by Mimeograph #3471, reported in Internal Revenue Cumulative Bulletin V-2, Pages 16 to 20, inclusive. The computation follows:

Earned net income	$7,913.24
Less:	
Personal exemption	3,500.00
Earned income subject to normal tax	$4,413.24
Normal tax at 1½% on $4,000.00	$ 60.00
Normal tax at 3% on 413.24	12.40
	$ 72.40
Earned income credit (25% of $72.40)	18.10

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

Copy.

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[36] Filed May 31, 1929. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 43,432.

BROWN, ARTHUR M.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ANSWER.

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1. Admits the allegations contained in Paragraph 1 of the petition.

2. Admits the allegations contained in Paragraph 2 of the petition.

3. Admits the allegations contained in Paragraph 3 of the petition.

4. Denies that Commissioner committed error in the matter of increase of partnership (Edward Brown & Sons) income for 1926 in the amount of $1,947.77.

5. Denies that the Commissioner erred as alleged in subdivisions 5 (a) and 5 (b) of Paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation set forth in taxpayer's petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
PHILIP M. CLARK,
Special Attorney,
Bureau of Internal Revenue.
CCH/MT.

[37] 22 B. T. A. ——.

United States Board of Tax Appeals.

DOCKET Nos. 35,305, 39,157 and 43,432.

Promulgated March 11, 1931.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

FINDINGS OF FACT AND OPINION.

1. The respondent's determination that a certain payment of money made by the petitioner to his sister in 1923, was a capital expenditure and not deductible in computing the petitioner's net income for that year, sustained.

2. Overriding commissions, representing a percentage of the net premiums written during the month, paid monthly by fire insurance companies to their general agents, as compensation for carrying on the affairs of the insurance companies in the territory in which they represent such companies, are income of the year in which received and may not be allocated to subsequent years through which the policies written during the taxable year are to run.

3. A reserve set aside out of the taxable year's earnings, to cover refunds of overriding commissions which the general agent may be required to make to the insurance companies, in the event of the cancellation or reinsurance

in later years of business written during the taxable year, is a contingent liability and may not be deducted from gross income in arriving at taxable net income.

ARTHUR B. DUNNE, Esq., KENNETH N. LOGAN, C. P. A., for the Petitioner.

EUGENE MEACHAM, Esq., for the Respondent.

The petitioner seeks a redetermination of deficiencies in income taxes, asserted by the respondent for the years, and in the amounts, as follows:

A true copy:

[Seal] Teste: B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

[38]

Docket No.	Year.	Deficiency.
35305	1923	$17,923.03
39157	1925	1,520.19
43432	1926	944.30

The petitioner alleges: (1) That the respondent erred in disallowing, as a deduction from business income for 1923, a payment of $3,000 made to petitioner's sister under a written agreement; and (2) that the income to petitioner's business for 1923, and to the successor partnership for 1925 and 1926, from commissions on insurance policies written, should be computed upon the basis of a *pro rata* apportionment of such commissions to the policy years; or, as an alternative, that the income from commissions should be computed by deducting from the gross commissions earned in each year, such an amount as the past experience of the business indicates will probably be refunded to insurance

companies on account of cancellation of policies. The proceedings were consolidated for hearing and decision.

FINDINGS OF FACT.

The petitioner, an individual, is a resident of the State of California.

From 1896 to 1904 the petitioner, his father, Edward Brown, and his brother, Herbert H. Brown, were engaged in business as general insurance agents. The senior Brown died in 1904, and until 1922 the business was carried on by the petitioner and Herbert H. Brown. The latter died in August, 1922, and throughout the remainder of 1922 and all of 1923 the business was conducted by the petitioner alone. On January 1, 1924, the [39] petitioner's son, Arthur M. Brown, Jr., was admitted as a partner, and throughout the taxable years 1925 and 1926 the business has been carried on by the partnership. During its entire existence the business has been carried on under the name of Edward Brown & Sons.

On June 1, 1902, Edward Brown, Herbert H. Brown, and the petitioner entered into a written agreement, as follows:

> Edward Brown, Arthur M. Brown and Herbert H. Brown, doing business under the firm name of EDWARD BROWN & SONS, as General Agents of Fire Insurance Companies, at 411–413 California Street, San Francisco, in the State of California, hereby agree and declare their respective interests in such business to be as follows:

After First setting apart and paying the sum of Two Hundred and Fifty Dollars ($250.00) per month as hereinafter provided for, the remaining profits to be divided as follows:

EDWARD BROWN to have four-tenths;

ARTHUR M. BROWN, to have four-tenths;

HERBERT H. BROWN to have two-tenths.

Bad debts and all other losses connected with the business to be borne by the several parties in like proportions.

Before any division of profits is made the said partners mutually agree to pay monthly to Jesse H. Jones, Edith H. Halton and Ethel Brown, (the three daughters of Edward Brown and Sisters of Arthur M. Brown and Herbert H. Brown), the sum of Two Hundred and Fifty Dollars ($250.00) and Further, that whenever the net income from the business of the said firm shall exceed the sum of Eighteen Thousand Dollars per annum they will pay a one-sixth proportion of such excess to the said Jessie H. Jones, Edith H. Halton, and Ethel Brown.

They further agree that in the case of the Death of one or more members of the said firm his or their heirs or executors shall be paid annually, for a term not exceeding ten years from the date, of the death of such member or members, such proportion of the net profits of said firm as hereinafter is proportion,

[40] To the heirs or executors of EDWARD BROWN, one-tenth;

To the heirs or executors of ARTHUR M. BROWN, two-tenths;

To the heirs or executors of HERBERT H. BROWN, one-tenth;

Provided that should Herbert H. Brown die before marrying no payment shall be required to be made to his heirs or executors.

It is further agreed that monthly installments on account of the said proportionate interest or interests shall be made on demand to such heirs or executors.

Witness our hands the date and place above mentioned.

EDWARD BROWN.
ARTHUR M. BROWN.
HERBERT H. BROWN.

Edward Brown died in the year 1904. On May 27, 1905, a written agreement was executed by and between Arthur M. Brown and Herbert H. Brown as surviving members of the firm of Edward Brown & Sons, and as heirs and as executors of the will of Edward Brown, deceased; Henry Michaels as executor fo said will of Edward Brown, and Jessie H. Jones, Edith H. Halton and Ethel Crandell as heirs and residuary legatees and devisees under the will of said Edward Brown, deceased, and Irene W. Brown as the widow and heir, and as legatee under the will of Edward Brown, deceased. Said written agreement of May 27, 1905, cannot now be found and there is no evidence as to its contents.

Jessie H. Jones, one of the petitioner's three sisters who were mentioned in the agreement of

June 1, 1902, and who were parties to the agreement of May 27, 1905, died subsequent to the latter date and prior to May 28, 1907. On May 28, 1907, Edith H. Halton and Ethel Crandell, the two surviving sisters, executed a written agreement which reads as follows:

> [41] We, Edith H. Halton and Ethel Crandell, the undersigned, and each of us, and the survivor of us, do and does hereby consent and agree to accept from the firm of Edward Brown & Sons, General Fire Insurance Agents, San Francisco, California, the sum of Two Hundred and *fifth* ($250.00) Dollars per month, commencing with the month beginning June 1st, 1907, and ending only by mutual agreement in full satisfaction for all amounts which may be due, or may become due, to us, or either of us, or to the survivor of us, from said firm, under and by reason of the provisions of that certain Agreement dated May 27, 1905, by and between Arthur M. Brown and Herbert H. Brown as surviving members of said firm and as Heirs, and as Executors of the Will of Edward Brown, deceased; Henry Michaels, as Executor of said Will; and Jessie H. Jones, Edith H. Halton and Ethel Crandell, as Heirs, and as residuary legatees and devisees under the Will, of Edward Brown, deceased; and Irene W. Brown, as Widow and as Heir, and as a legatee under the Will, of Edward Brown, deceased; Provided that any further amounts to which we, or either of us, or the survivor of us, might

be entitled from said firm under said agreement shall be retained in the net profits of said firm as the property and to the credit of said Arthur M. Brown and Herbert H. Brown, members of said firm, to be divided between them as they may agree.

This agreement has never been modified in any particular. In 1923, the petitioner made a payment of $3,000 to his sister Edith H. Halton in accordance with the foregoing agreements, and claimed the same as a deduction from business income in his return for that year. The deduction has been disallowed by the respondent on the ground that the payment constituted a capital expenditure.

During the taxable years in controversy the firm of Edward Brown & Sons acted as general agents, in eleven Pacific coast and adjacent states, the territories of Alaska and Hawaii, the Philippine Islands, and the Province of British Columbia, for six fire insurance companies, namely: Hamilton Fire [42] Insurance Company, Globe & Rutgers Fire Insurance Company of New York City, Brand & Lifforsakrings Aktiebolaget Svea, Agricultural Insurance Company of Watertown, New York, Hudson Insurance Company of New York and United States Merchants & Shippers Insurance Company. The firm's relations with the two first mentioned companies were fixed by conversations with officers of those companies and the acts of the parties. Its relations with the other four companies were fixed by written agreements.

The duties required of and performed by the firm

were substantially the same for all six companies. The firm appointed and removed local agents; accepted service of process; adjusted losses under policies; received and acknowledged service of proof of loss; issued, countersigned and cancelled policies; received and receipted for premiums, surveyed all risks offered and accepted or rejected the same; represented its principals on the Pacific Board of Fire Underwriters; computed and paid commissions due local agents; ceded or reinsured certain lines of business with treaty or other companies; computed and paid return premiums on cancelled policies; secured return of premium on cancelled reinsurance; rendered all reports required of its principals by the authorities of political subdivisions in the territory in which it operated; attended to the payment of all license fees and taxes; furnished all necessary printed matter, except policy blanks, to local agents; transferred insurance by endorsement; determined whether its principals should participate in special pools; and generally attended to all of the affairs of its principals in the territory in which it operated.

[43] Under the arrangements with the insurance companies it represented, the firm received, as compensation, a percentage of the net profits on business written in its territory, and so-called "overriding commissions" which are stated percentages of the net premiums written. By net premiums is meant gross premiums written less return premiums and net cost of reinsurance.

All policies written by the firm, since 1917, are

for periods of one, three, or five years, and contain provisions for cancellation by the insurance company or the assured. If the insurance company cancels, it is obligated to refund a ratable proportion of the premium for the unexpired term of the policy; if the assured cancels, the company is entitled to retain the customary short period rate for the time the policy has been in force.

All premiums on policies written by the firm are payable in advance, subject to the usual grace period of 60 days.

The firm makes remittances to the insurance companies on monthly balances, crediting itself with, among other things, the overriding commissions due on the business written during the month, and charging itself, among other things, a proportional part of any overriding commissions previously received in respect of any business which was cancelled, or reinsured in another company, during the month.

The following is a statement by five year periods, from 1919 to 1926, of gross fire premiums written by the firm, fire premiums cancelled, and ratio of premiums cancelled to gross premiums written, as shown by the firm's books of account:

[44]

Five Year Period	Gross fire premiums written	Fire premiums cancelled	Ratio
1919 to 1923	$14,893,022	$3,333,104	22.38%
1920 to 1924	15,647,482	3,492,101	22.32
1921 to 1925	15,931,443	3,432,670	21.55
1922 to 1926	17,155,359	3,624,071	21.13

The firm's books of account have been kept consistently on an accrual basis. Overriding commissions on new business have been accounted income of the year in which the business was written; and refunds of overriding commissions, on account of policy cancellations or reinsurance, have been accounted expense of the year of cancellation or reinsurance.

At the close of 1923, for the first time, a liability account denominated "Return Commissions" was set up on the firm's books. The purpose of the account was to record the firm's contingent liability to refund to insurance companies a portion of the overriding commissions received during the year, on account of future cancellations and the reinsurance of business written during the year. At the close of each of the years 1924 to 1926, inclusive, the credit balance in the account was adjusted to reflect the same proportion of the overriding commissions received during the year as the total fire premiums cancelled in the next preceding five year period bear to the gross fire premiums written in the same period.

In computing business income for 1923, the petitioner claimed a deduction of $52,971.96, the amount credited to the contingent liability account at the close of that year. In computing the partnership net income for 1925 and 1926 deductions of $3,292.98 and $1,947.77, respectively, were claimed, representing the net additions to the contingent liability account in those years. All three deductions have been disallowed by the respondent.

[45] OPINION.

MARQUETTE.—The first question presented by the record herein is whether the petitioner in computing his net income for 1923 is entitled to deduct the amount he paid to his sister Edith H. Halton in that year under the circumstances set forth in the findings of fact. The petitioner contends that the sister had an interest in the business of Edward Brown & Sons that antedated the death of Edward Brown, and that the amount paid to her represented her distributive share of the profits. The respondent has determined, and now maintains, that the payment to Edith H. Halton represented a capital expenditure by the petitioner.

On the record we cannot disturb the respondent's determination. The petitioner, his father and his brother entered into an agreement among themselves on June 1, 1902, providing for the payment of a certain part of the profits of the partnership to the three daughters of Edward Brown (the sisters of the petitioner). Edward Brown died in 1904 and on May 27, 1905, a written contract was executed by the petitioner and his brother as surviving members of the partnership and as heirs and executors of Edward Brown, deceased, and by their three sisters as heirs and legatees under the last will and testament of Edward Brown, that apparently superseded the agreement of June 1, 1902. What the contract of May 27, 1905, provided for or reserved to the daughters of Edward Brown, we do not know, but in any event the surviving

daughters agreed in writing on May 28, 1907, to accept $250 per month in satisfaction of all amounts "which may be due, or may become due, to us, or either of us, or to the survivor of us" from the firm of Edward Brown & Sons under the agreement of May 27, 1905. Since we are not [46] informed as to the terms of the contract of May 27, 1905, we are unable to determine what interest, if any, the sisters had in the business of Edward Brown & Sons under that agreement. Nor can we say, in the absence of that information, that the amount of $3,000 per year paid by the petitioner to his sister in 1923 pursuant to the agreement of June 1, 1907, was a capital expenditure. The respondent has determined that it was a capital expenditure and the burden is upon the petitioner to show otherwise, which he has failed to do.

The second issue is as to the proper method of treating the overriding commissions received by Edward Brown & Sons during the taxable years in controversy. The petitioner contends that they should be returned as income upon the basis of a *pro rata* apportionment of such commissions to the policy years. In other words the petitioner contends that as to overriding commissions received for writing one year policies, one-half should be returned as income of the year in which the policy was written and one-half as income of the next year; that as to commissions received for writing three year policies, one-sixth should be returned as income of the year in which the policy was written, one-third as income of each of the first and second

succeeding years, and one-sixth as income of the third succeeding year; and that as to commissions received for writing five year policies, one-tenth should be returned as income of the year in which the policy was written, one-fifth as income of each of the first, second, third and fourth succeeding years, and one-tenth as income of the fifth succeeding years. The method assumes that all policies written in any one year were issued as of the average date of July 1, and, in that [47] respect, resembles the method generally used by insurance companies for computing the unearned premium reserve.

It is to be observed that the method of computing overriding commissions income now contended for is not the method employed in keeping the firm's books of account. It has been the firm's consistent practice to account for overriding commissions on new business as income of the year in which the business was written; and any departure from that practice now can only be justified on the ground that net income will be more clearly reflected. Section 212 (b) Revenue Acts of 1921, 1924 and 1926.

It is argued in petitioner's behalf that the overriding commissions paid by the insurance companies to the firm of Edward Brown & Sons, in any one year, represent compensation for services rendered in that year and compensation for services to be rendered in later years while the policies, in respect of which the commissions were paid, continue in force; that such portion of the commissions as rep-

resents compensation for services to be rendered in later years cannot be considered as earned until the required services have been performed; and that the taxing statutes contemplate that a taxpayer keeping books on the accrual basis shall account for income only as it is actually earned.

The argument assumes much for which there is no support in the record. There is no proof that the overriding commissions contain any element of compensation for services to be rendered in future years. On that point the contracts are entirely silent; and there is no positive evidence that the payment of these commissions by the insurance companies created any obligation on the part of the firm to continue to render services while the policies continued in force. The firm made monthly settlements with the insurance [48] companies, withholding the overriding commissions to which it was entitled on the business written during the month. For aught that the written contracts provide, the firm could have ceased to do business following any one of such settlements without any obligation to render further services or to refund any part of the overriding commissions, except in the event of cancellation of any one of the policies prior to the ends of the terms for which they were written or in case of reinsurance of any part of the business covered by those policies.

The argument also assumes that the overriding commissions are paid solely for such services as may be required in connection with the procuring of new business and the adjustment of matters

arising out of the policy contracts. This is clearly not the case. The compensation provisions of the contracts, which base the compensation, in part, upon stated percentages of the net premiums written, provide merely the measure of the compensation to be paid the firm for carrying on all of the duties of a general agency. These duties include many which cannot be definitely related to any particular line of business, such as, the appointment and removal of local agents, representation of the firm's principals on the Pacific Board of Fire Underwriters, preparation and submission of reports required of the firm's principals by the authorities of political subdivisions in the territory in which the firm operates, attending to the payment of all fees, licenses and taxes, furnishing descriptive advertising to local agents, etc.; and for these duties the firm is compensated, in part, out of the overriding commissions.

[49] In our opinion, the overriding commissions withheld by the firm in its settlements with the insurance companies represent compensation for services rendered in the periods covered by those settlements, constitute earnings of those periods, and must be accounted for as income of the same periods. Cf. Automobile Underwriters, Inc., 19 B. T. A. 1160.

As an alternative, the petitioner seeks to compute its commission income by deducting from the gross commissions earned in each year, such an amount as the past experience of the business indicates will probably have to be refunded to insurance companies on account of cancellation of

policies and reinsurance with other companies, the amount to be deducted in each year being the same proportion of the gross commissions earned within the year as the total fire premiums cancelled during the preceding five-year period bears to the gross fire premiums written in the same period. This is merely an attempt to compute the income of the years in controversy upon a basis that will reflect the contingencies of the future. Essentially it is not different from the setting up of a reserve for future contingencies; and however certain it may appear, from the past experience of the business, that such contingencies will arise, such procedure is clearly not countenanced by the taxing statutes. William J. Ostheimer, 1 B. T. A. 18; Consolidated Asphalt Co., 1 B. T. A. 79; Uvalde Co., 1 B. T. A. 932; Thomas Cronin Co. v. Lewellyn, 9 Fed. (2d) 974; Pan-American Hide Co., 1 B. T. A. 1249; Morrison-Ricker Mfg. Co., 2 B. T. A. 1008; Thatcher Medicine Co., 3 B. T. A. 154; Greenville Coal Co., 3 B. T. A. 1323; H. Northwood & Co., 4 B. T. A. 697; [50] Lane Construction Corporation, 4 B. T. A. 1133; H. V. Greene Co., 5 B. T. A. 442; Liberty Agency Co., 5 B. T. A. 778; Farmers National Bank, 6 B. T. A. 1036; Frank J. Jewell, 6 B. T. A. 1040; Lehigh & Hudson River Railroad Co., 13 B. T. A. 1154; Lane Construction Corporation, 17 B. T. A. 826; Automobile Underwriters, Inc., *supra.* See, also, Consolidated Tea Co. vs. Bowers, 19 Fed. (2d) 382; and Malleable Iron Range Co. vs. United States, 62 Ct. Cls. 425.

Judgment will be entered under Rule 50.

[51] United States Board of Tax Appeals.

DOCKET No. 35,305.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

Pursuant to the findings of fact and opinion of the Board in the above-entitled proceedings promulgated March 11, 1931, the respondent has filed a motion for judgment in accordance with said findings of fact and opinion. Now, upon consideration thereof, it is

ORDERED AND DECIDED, upon redetermination, that the petitioner's deficiency in tax for the year 1923 is $17,923.03.

(Signed) JOHN J. MARQUETTE,
Member, United States Board of Tax Appeals.

Entered Apr. 25, 1931.

A true copy.

[Seal] Teste: B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

[52] United States Board of Tax Appeals

DOCKET No. 39,157.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

Pursuant to the findings of fact and opinion of the Board in the above-entitled proceedings promulgated March 11, 1931, the respondent has filed a motion for judgment in accordance with said findings of fact and opinion. Now, upon consideration thereof, it is

ORDERED AND DECIDED, upon redetermination, that the petitioner's deficiency in tax for the year 1925 is $1,520.19.

(Signed) JOHN J. MARQUETTE,
Member, United States Board of Tax Appeals.

Entered Apr. 25, 1931.

A true copy.

[Seal] Teste: B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

[53] United States Board of Tax Appeals.

DOCKET No. 43,432.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

Pursuant to the findings of fact and opinion of the Board in the above-entitled proceeding promulgated March 11, 1931, the respondent has filed a motion for judgment in accordance with the said findings of fact and opinion. Now, upon consideration thereof, it is

ORDERED AND DECIDED, upon redetermination, that the petitioner's deficiency in tax for the year 1926 is $944.30.

(Signed) JOHN J. MARQUETTE,
Member, United States Board of Tax Appeals.

Entered Apr. 25, 1931.

A true copy.

[Seal] Teste: B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

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[54] Filed Aug. 27, 1931. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 35,305.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION AND ORDER RE CONSOLIDATION ON APPEAL.

Three separate matters having been pending before the United States Board of Tax Appeals, each entitled "Arthur M. Brown, Petitioner, against Commissioner of Internal Revenue, Respondent," and numbered on the files of the said United States Board of Tax Appeals respectively, Docket Numbers 35,305, 39,157 and 43,432; and

Said matters having come on for hearing upon the same date and before the same Member of said United States Board of Tax Appeals and by consent having been tried and heard and decided together, upon the same evidence,—

NOW, IT IS STIPULATED by the parties that should the petitioner in said three matters perfect an appeal from the decisions of the United States Board of Tax Appeals in said three named matters, and to the United States Circuit Court of Appeals for the Ninth Circuit, that said three matters may be

consolidated on appeal; that the petitioner for review need prepare and file but one statement of evidence as incident to said appeal and the preparation of a record therefor, which said statement of evidence shall serve and be considered in all of said three named matters and said three matters may be heard on one transcript on appeal which shall include said statement of evidence and in addition all steps and matters separately and severally appearing in each one of said three named proceedings and particularly, and agreeable to rule 38 [55] of the rules of the United States Circuit Court of Appeals for the Ninth Circuit, shall include in addition to said statement of evidence the docket entries of the proceedings before the Board in each of said three named proceedings, pleading before the Board in each of said three named proceedings, findings of fact, opinion and decision of the Board in each of said three named proceedings, petition for review in each of said three named proceedings, and any other papers or matters appearing in any of said proceedings pertinent to said petition for review and proper to be included in said transcript, and that the clerk in certifying to any papers or records to be forwarded to the Circuit Court of Appeals for the Ninth Circuit may include all papers necessary in any of said three named matters in a single transcript, and that said three named matters may be consolidated for hearing and determination

upon any proceeding to review the decision in any of said three named matters.

Dated ———, 1931.

(Signed) ARTHUR B. DUNNE,
Attorney and Counsel for Petitioner,
920 Insurance Exchange Building,
San Francisco, California.

(Signed) KENNETH N. LOGAN,
Accountant and Counsel for Petitioner,
1222 Balfour Building,
San Francisco, California.

(Signed) C. M. CHAREST,
F.,
General Counsel, Bureau of Internal Revenue,
For Respondent.

So ordered.

Dated: ———, 1931.

———,
Member.

———

[56] Filed Aug. 27, 1931. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 39,157.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION AND ORDER RE CONSOLIDATION ON APPEAL.

Three separate matters having been pending before the United States Board of Tax Appeals, each entitled "Arthur M. Brown, Petitioner, against Commissioner of Internal Revenue, Respondent," and numbered on the files of the said United States Board of Tax Appeals respectively, Docket Numbers 35,305, 39,157 and 43,432; and

Said matters having come on for hearing upon the same date and before the same Member of said United States Board of Tax Appeals and by consent having been tried and heard and decided together, upon the same evidence,—

NOW, IT IS STIPULATED by the parties that should the petitioner in said three matters perfect an appeal from the decisions of the United States Board of Tax Appeals in said three named matters, and to the United States Circuit Court of Appeals for the Ninth Circuit, that said three matters may be consolidated on appeal; that the petitioner for review need prepare and file but one statement of evidence as incident to said appeal and the preparation of a record therefor, which said statement of evidence shall serve and be considered in all of said three named matters and said three matters may be heard on one transcript on appeal which shall include said statement of evidence and in addition all steps and matters separately and severally appearing in each one of said three named proceedings and particularly, and agreeable to rule 38 [57]

of the rules of the United States Circuit Court of Appeals for the Ninth Circuit, shall include in addition to said statement of evidence the docket entries of the proceedings before the Board in each of said three named proceedings, pleadings before the Board in each of said three named proceedings, findings of fact, opinion and decision of the Board in each of said three named proceedings, petition for review in each of said three named proceedings, and any other papers or matters appearing in any of said proceedings pertinent to said petition for review and proper to be included in said transcript, and that the clerk in certifying to any papers or records to be forwarded to the Circuit Court of Appeals for the Ninth Circuit may include all papers necessary in any of said three named matters in a single transcript, and that said three named matters may be consolidated for hearing and determination upon any proceeding to review the decision in any of said three named matters.

Dated: ————, 1931.

(Signed) ARTHUR B. DUNNE,
Attorney and Counsel for Petitioner,
920 Insurance Exchange Building,
San Francisco, California.

(Signed) KENNETH N. LOGAN,
Accountant and Counsel for Petitioner,
1222 Balfour Building,
San Francisco, California.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
For Respondent.

So ordered.
Dated: ———, 1931.

_____,
Member.

[58] Filed Aug. 27, 1931. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 43,432.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION AND ORDER RE CONSOLIDATION ON APPEAL.

Three separate matters having been pending before the United States Board of Tax Appeals, each entitled "Arthur M. Brown, Petitioner, against Commissioner of Internal Revenue, Respondent," and numbered on the files of the said United States Board of Tax Appeals respectively, Docket Numbers 35,305, 39,157 and 43,432; and

Said matters having come on for hearing upon the same date and before the same Member of said United States Board of Tax Appeals and by consent having been tried and heard and decided together, upon the same evidence,—

NOW, IT IS STIPULATED by the parties that should the petitioner in said three matters perfect an appeal from the decisions of the United States Board of Tax Appeals in said three named matters, and to the United States Circuit Court of Appeals for the Ninth Circuit; that said three matters may be consolidated on appeal; that the petitioner for review need prepare and file but one statement of evidence as incident to said appeal and the preparation of a record therefor, which said statement of evidence shall serve and be considered in all of said three named matters and said three matters may be heard on one transcript on appeal which shall include said statement of evidence and in addition all steps and matters separately and severally appearing in each one of said three named proceedings and particularly, and agreeable to rule 38 [59] of the rules of the United States Circuit Court of Appeals for the Ninth Circuit, shall include in addition to said statement of evidence the docket entries of the proceedings before the Board in each of said three named proceedings, pleadings before the Board in each of said three named proceedings, findings of fact, opinion and decision of the Board in each of said three named proceedings, petition for review in each of said three named proceedings, and any other papers or matters appearing in any of said proceedings pertinent to said petition for review and proper to be included in said transcript, and that the Clerk in certifying to any papers or records to be forwarded to the Circuit Court of Appeals for the Ninth Circuit may in-

clude all papers necessary in any of said three named matters in a single transcript, and that said three named matters may be consolidated for hearing and determination upon any proceeding to review the decision in any of said three named matters.

Dated: ————, 1931.

(Signed) ARTHUR B. DUNNE,
Attorney and Counsel for Petitioner,
920 Insurance Exchange Building,
San Francisco, California.

(Signed) KENNETH N. LOGAN,
Accountant and Counsel for Petitioner,
1222 Balfour Building,
San Francisco, California.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
For Respondent.

So ordered.

Dated: ————, 1931.

————————,
Member.

———

[60] Filed Sept. 8, 1931.

United States Board of Tax Appeals.

DOCKET No. 35,305.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW OF DECISION OF UNITED STATES BOARD OF TAX APPEALS BY UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Your petitioner, Arthur M. Brown, feeling himself aggrieved by the decision of the United States Board of Tax Appeals rendered and made herein and entered herein on the 25th day of April, 1931, redetermining a deficiency on the income tax (normal tax and surtax) of petitioner for the calendar year, 1928, in an amount of Seventeen Thousand Nine Hundred Twenty-three and 03/100 Dollars ($17,923.03), does hereby appeal from said decision and redetermination and does hereby petition that said decision and redetermination be reviewed pursuant to the statutes and [61] rules in such cases made and provided, and in that behalf respectfully shows as follows:

1. Petitioner is an individual, and petitioner is now, and at all times herein mentioned was, residing at San Francisco, State of California, and is now, and at all times herein mentioned was, an inhabitant of the State of California and of the Ninth of the Circuits established for the United States Circuit Court of Appeals. Petitioner, pursuant to the provisions of law in that behalf made and provided, duly filed with the Collector of Internal Revenue for the First District of California, at

San Francisco, California, his return of his income for the calendar year, 1923. Thereafter, the Honorable, the Commissioner of Internal Revenue, respondent herein, assessed against petitioner and on account of the income of petitioner for the calendar year, 1923, a deficiency. Thereafter, and within the time allowed by law, petitioner, feeling himself aggrieved by said determination, did, pursuant to the provisions of law in said cases made and provided, petition the Honorable, the United States Board of Tax Appeals, to review said determination. Respondent herein having appeared and answered said petition said matter did come on duly and regularly to be heard before the said, the Honorable, the United States Board of Tax Appeals, and thereafter, and on the 11th day of March, 1931, said, the Honorable, the United States [62] Board of Tax Appeals did promulgate and render and file its findings of fact and opinion herein in favor of respondent, and adverse to your petitioner, and thereafter, and upon motion of respondent for judgment, and on the 25th day of April, 1931, did, in accordance with said findings and opinion, render, make, file and enter herein, its decision and judgment ordering and deciding, upon redetermination, that the deficiency in the tax of petitioner for the year, 1923, is the sum of Seventeen Thousand Nine Hundred Twenty-three and 03/100 Dollars ($17,923.03).

2. Petitioner hereby seeks review of said determination and decision and judgment by the United

States Circuit Court of Appeals for the Ninth Circuit.

3. The nature of the controversy is as follows:

(a) The income of petitioner for the calendar year, 1923, and as to which there is a controversy, was derived by petitioner from the conduct at San Francisco, California, of the business of insurance general agent, conducted by him but as to which he asserts his sister, Edith H. Halton, had a participating interest. Said business was conducted under the fictitious name of "Edward Brown & Sons," and consisted in the representation, in all aspects of their business, of various insurance companies in the State of California, other western states of the United States, and elsewhere. From the proceeds of said business [63] for the year, 1923, petitioner paid to his sister, Edith H. Halton, the sum of Three Thousand Dollars ($3,000). Petitioner, in returning his income for the year, 1923, and in computing his own income, deducted this sum of Three Thousand Dollars ($3,000). This deduction respondent refused to allow. Petitioner asserted, and now asserts, that said payment made to his sister was made by reason of the fact that she had a limited interest in said business, and that the same was a joint venture as between himself and his said sister, and that said payment represented no more than the participation by his said sister in the profits of said business, by reason of her proprietary interest therein. Respondent disallowed said claim upon the ground asserted, that said sister of petitioner, Edith H. Halton, had

had a proprietary interest in said business, and that the same had been acquired by her said brother, your petitioner, in return for certain considerations consisting in yearly payments by petitioner to his said sister, and that said payment of Three Thousand Dollars ($3,000) was one of said yearly payments, made for the purpose of acquiring her asserted proprietary interest, and was not a proper deduction from income but was a capital expenditure.

(b) The business conducted by petitioner as aforesaid and on behalf of various insurance companies consisted in the management of the business of said companies, and, particularly, in the writing of insurance for them. The policies of insurance for said companies so written during the calendar year, 1923, and for [64] years prior thereto, and after 1923, were policies written for definite terms which said terms were one, three and five years. Part of the compensation paid to petitioner on account of said services rendered as aforesaid consisted in the payment to petitioner of a percentage of the premiums collected on such insurance written as aforesaid, which said percentage was determined by contract between petitioner and the insurance companies represented by him and for whom he acted. This was known as overriding commission. Upon cancellation of any insurance written as aforesaid before the expiration of a term for which the same was written, the unearned portion of the premium for insurance was required to be returned to the assured, and, accordingly, on such cancella-

tion by either the assured or the insurance company, and on the return of such premium, petitioner was required to refund such proportion of the overriding commission as the refunded part of the premium bore to the full premium. Long experience showed that the percentage of premiums refunded by reason of cancellation and consequent refund of overriding commission was between 21% and 23% during a given year. In making his return for the year, 1923, petitioner deducted from his income for that year Fifty-two Thousand Nine Hundred Seventy-one and 96/100 Dollars ($52,-971.96) on account of return which would have to be made by him from overriding commissions paid to him by reason [65] of cancellation and consequent return of premium with respect to policies written by him during the calendar year, 1923. Such deduction was disallowed by the respondent, and the respondent now claims that the same is improper, by reason of the fact that no reserve can lawfully be set up in such manner, and by reason of the fact that the liability to return unearned overriding commission is contingent only. The books of petitioner for the calendar year, 1923, were kept on an accrual basis. Petitioner further asserts that the services for which said overriding commissions are paid are not completed upon writing of the policies, but extend and are performed throughout the whole of the life of each policy. Petitioner further asserts that if the foregoing method of returning overriding commission income is improper, that then he is entitled to return said in-

come, not on a cash basis and as received, but on an accrual basis and only as earned, and that, accordingly, his books being kept on an accrual basis, and his income being a percentage of premiums on policies written during the year, 1923, but for terms which will extend beyond 1923, he should return of such income for the year, 1923, only such portion thereof as is represented by the life of such policy during the year, 1923, and, consequently, only such portion thereof as is earned during the year, 1923; that his said income, being a percentage of premiums earned on policies, is earned only over the life of the policy, as is the [66] premium, and, accordingly, in any one year only such proportion should be returned as corresponds to the life of the policy in said particular year and is earned in said year. Respondent contended that overriding commission income should be returned in the year in which received, irrespective of the nature of the policy or policies on the premiums of which it was computed, and that to return it as earned would be to return it in a method not followed in keeping the books of account of petitioner.

4. Your petitioner respectfully assigns as error committed by the Honorable, the United States Board of Tax Appeals, in the hearing and determination of the above-entitled matter, the following:

(a) Error in determining that there was any deficiency as to the tax due from petitioner and on account of income of petitioner for the year, 1923, and in failing to find and determine that there was

no deficiency due from petitioner on account of the income and surtax of petitioner with respect to the income of petitioner for the year, 1923.

(b) Error in determining that the Three Thousand Dollars ($3,000) paid by petitioner to Edith H. Halton, as hereinbefore set out, was not a proper deduction in computing the gross income and the net income of petitioner for the year, 1923, and in determining that the same was a capital expenditure.

[67] (c) Error in determining that the Fifty-two Thousand Nine Hundred Seventy-one and 96/100 Dollars ($52,971.96) deducted by petitioner in computing petitioner's taxable income for the year, 1923, and deducted on account of petitioner's liability to return overriding commission income by reason of cancellation of policies, was not a proper deduction.

(d) Error in determining that the figure Fifty-two Thousand Nine Hundred Seventy-one and 96/100 Dollars ($52,971.96), or any other figure set up as a deduction by reason of liability to return overriding commissions received, by reason of cancellation of policies on the premiums of which said overriding commission was computed, was not a proper deduction and was in substance a reserve against future contingencies.

(e) Error in determining that however certain it may appear from past experience of a business that contingencies will arise requiring an outlay and return of an income, a procedure of setting up a fund to meet such liability is not countenanced by the taxing statutes.

(f) Error in determining that petitioner's overriding commission income, being a percentage of the premiums of policies written by petitioner, was earned when received, and in determining that the same was not earned over the life of the policy to which the same related, and on the premium of which the same was computed and was only so earned.

[68] (g) Error in determining that overriding commission income of petitioner was earned when received and must be returned for the year in which the same was received, and could not be returned as earned over the lives of the policies on the premiums of which the same was computed.

(h) Error in determining that to return overriding commission income on an accrual basis, and to return the same as earned, and to return the same on the basis that it was earned over the life of the policies on the premiums of which it was computed, was to return the income of petitioner by a method different from the method used in keeping the books of petitioner and different from the method shown on the books of petitioner.

(i) As to each of the foregoing determinations specified to have been erroneous, petitioner further specifies that each and every one thereof was unsupported and is unsupported by the evidence.

(j) Error in rejecting petitioner's offer of the reports of the internal revenue agent with respect to the income of petitioner for the year, 1923, being Petitioner's Exhibit No. 17, for identification, and in striking out a portion thereof theretofore re-

ceived in evidence, and stating that the accounts in connection with the general insurance agency of taxpayer may be said to be kept on an accrual basis.

[69] (k) Error in rejecting evidence offered by petitioner, to wit, Petitioner's Exhibit No. 26 for identification.

(l) Error in rejecting evidence offered by petitioner, to wit, Petitioner's Exhibit No. 28 for identification.

WHEREFORE, petitioner prays:

1. That a record of all of the proceedings herein be made up and certified to the United States Circuit Court of Appeals for the Ninth Circuit, and that this appeal be allowed, and that said court review the action and determination of the United States Board of Tax Appeals in this cause.

2. That it be determined that there is no deficiency due on account of the income tax or surtax of petitioner, and with respect to the income of petitioner for the year, 1923, and that the determination of the United States Board of Tax Appeals in that behalf be vacated.

3. That it be determined that the Three Thousand Dollars ($3,000) paid by said petitioner to Edith H. Halton is a proper deduction in the computation of the tax of petitioner as aforesaid.

4. That petitioner be permitted, in returning his income, to return overriding commission income, not as received but as earned.

5. That in the event overriding commission income is not to be returned as earned, that then

petitioner, in computing [70] his income for purposes of taxation, be permitted to deduct from gross overriding commission income received in any one year the liability incident thereto, to return a portion thereof on cancellation of policies on the premiums of which the said commission was computed.

6. That the errors hereinbefore assigned be corrected and judgment entered accordingly.

7. For such other, further and different relief as, the premises considered, is proper.

ARTHUR B. DUNNE,
Attorney for Petitioner,
920 Insurance Exchange Building,
San Francisco, California.

KENNETH N. LOGAN,
Accountant for Petitioner,
Balfour Building, San Francisco,
California.

[71] State of California,
City and County of San Francisco,—ss.

Arthur M. Brown, being first duly sworn, deposes and says:

That he is the petitioner named in the foregoing petition; that he has read the foregoing petition, and knows the contents thereof, and that the same is true of his own knowledge, except as to matters therein stated on information or belief, and that as to those matters he believes it to be true; that the same is not filed for purposes of delay, and that he verily believes that he is justly entitled to the relief sought.

ARTHUR M. BROWN.

Subscribed and sworn to before me this 3d day of September, 1931.

[Notarial Seal] KATHRYN E. STONE,
Notary Public in and for the City and County of San Francisco, State of California.
My commission expires March 1, 1933.

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[72] Filed Sept. 9, 1931.

United States Board of Tax Appeals.

DOCKET No. 35,305.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

NOTICE OF FILING OF PETITION FOR REVIEW.

To the Honorable, the Commissioner of Internal Revenue, Respondent Above Named, Washington, D. C., and to His Attorney:

You are hereby notified that on the 8th day of September, 1931, petitioner above named filed with the United States Board of Tax Appeals, his petition for review of the decision of the United States Board of Tax Appeals, in the above-entitled cause, entered herein on the 25th day of April, 1931, redetermining a deficiency in the taxes of petitioner for the year 1925, by the United States Circuit

Court of Appeals for the Ninth Circuit, and that attached hereto is a copy of said petition.

ARTHUR B. DUNNE,
Attorney for Petitioner,
920 Insurance Exchange Bldg.,
San Francisco, California.

KENNETH N. LOGAN,
Accountant for Petitioner,
Balfour Building, San Francisco,
California.

[73] Due service of the foregoing notice and attached copy of petition and receipt of copies thereof is hereby admitted this 9th day of September, 1931.

_____,
Commissioner of Internal Revenue.
By C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

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[74] Filed Sept. 8, 1931.

United States Board of Tax Appeals.

DOCKET No. 39,157.

ARTHUR M. BROWN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REVIEW OF DECISION OF UNITED STATES BOARD OF TAX APPEALS BY UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Your petitioner, Arthur M. Brown, feeling himself aggrieved by the decision of the United States Board of Tax Appeals rendered and made herein and entered herein on the 25th day of April, 1931, redetermining a deficiency on the income tax (normal tax and surtax) of petitioner for the calendar year, 1925, in an amount of One Thousand Five Hundred Twenty and 19/100 Dollars ($1,520.19), does hereby appeal from said decision and redetermination and does hereby petition that said decision and redetermination be reviewed pursuant to the statutes and rules in such [75] cases made and provided, and in that behalf respectfully shows as follows:

1. Petitioner is an individual, and petitioner is now, and at all times herein mentioned was, residing at San Francisco, State of California, and is now, and at all times herein mentioned was, an inhabitant of the State of California and of the Ninth of the Circuits established for the United States Circuit Courts of Appeals. Petitioner, pursuant to the provisions of law in that behalf made and provided, duly filed with the Collector of Inter-

nal Revenue for the First District of California, at San Francisco, California, his return of his income for the calendar year, 1925. Thereafter, the Honorable, the Commissioner of Internal Revenue, respondent herein, assessed against petitioner and on account of the income of petitioner for the calendar year, 1925, a deficiency. Thereafter, and within the time allowed by law, petitioner, feeling himself aggrieved by said determination, did, pursuant to the provisions of law in said cases made and provided, petition the Honorable, the United States Board of Tax Appeals, to review said determination. Respondent herein having appeared and answered said petition said matter did come on duly and regularly to be heard before the said the Honorable, the United States Board of Tax Appeals, and thereafter, and on the 11th day of March, 1931, said, the Honorable, the United [76] States Board of Tax Appeals did promulgate and render and file its findings of fact and opinion herein in favor of respondent, and adverse to your petitioner, and thereafter, and upon motion of respondent for judgment, and on the 25th day of April, 1931, did, in accordance with said findings and opinion, render, make, file and enter herein, its decision and judgment ordering and deciding, upon redetermination, that the deficiency in the tax of petitioner for the year, 1925, is the sum of One Thousand Five Hundred Twenty and 19/100 Dollars ($1,520.19).

2. Petitioner hereby seeks review of said determination and decision and judgment by the United

States Circuit Court of Appeals for the Ninth Circuit.

3. The nature of the controversy is as follows:

During the year, 1925, petitioner and his son, Arthur M. Brown, Jr., as copartners, conducted a general insurance agency business under the fictitious name of "Edward Brown & Sons," and the income of petitioner for the year, 1925, as to which there is a controversy, was the petitioner's share of the income of said partnership derived from "overriding commissions" on account of said business. The business conducted as aforesaid and on behalf of various insurance companies consisted in the management of the business of said companies, and, particularly, in the writing of insurance for them. The policies of insurance [77] for said companies so written during the calendar year, 1925, and for years prior thereto, and after 1925, were policies written for definite terms which said terms were one, three and five years. Part of the compensation paid on account of said services rendered as aforesaid consisted in the payment of a percentage of the premiums collected in such insurance written as aforesaid, which said percentage was determined by contract between said partnership and the insurance companies represented by it and for whom it acted. This was known as overriding commission. Upon cancellation of any insurance written as aforesaid before the expiration of a term for which the same was written, the unearned portion of the premium for insurance was required to be returned to the assured, and, ac-

cordingly, on such cancellation by either the assured or the insurance company, and on the return of such premium, there was required to be refunded such proportion of the overriding commission as the refunded part of the premium bore to the full premium. Long experience showed that the percentage of premiums refunded by reason of cancellation and consequent refund of overriding commission was between 21% and 23% during a given year. In making his return for the year, 1925, petitioner deducted in computing said partnership's net income for that year Three Thousand Two Hundred Ninety-two and 98/100 Dollars ($3,292.98) on account of return which would have to be made from overriding commissions paid by reason of cancellation and consequent return of premium with respect to [78] policies written during the calendar year, 1925. Such deduction was disallowed by the respondent, and the respondent now claims that the same is improper, by reason of the fact that no reserve can lawfully be set up in such manner, and by reason of the fact that the liability to return unearned overriding commission is contingent only. The books of said partnership for the calendar year, 1925, were kept on an accrual basis. Petitioner further asserts that the services for which said overriding commissions are paid are not completed upon writing of the policies, but extend and are performed throughout the whole of the life of each policy. Petitioner further asserts that if the foregoing method of returning overriding commission income is improper, that then he

is entitled to return said income, not on a cash basis and as received, but on an accrual basis and only as earned, and that, accordingly, the books being kept on an accrual basis, and his income being a percentage of premiums on policies written during the year, 1925, but for terms which will extend beyond 1925, he should return of such income for the year, 1925, only such portion thereof as is represented by the life of such policy during the year, 1925, and, consequently, only such portion thereof as is earned during the year, 1925; that his said income, being a percentage of premiums earned on policies, is earned only over the life of the policy, as is the premium, and, accordingly, in any one year only such proportion should be returned as corresponds to the life of the policy in said particular year and is earned in said year. Respondent [79] contended that overriding commission income should be returned in the year in which received, irrespective of the nature of the policy or policies on the premiums of which it was computed, and that to return it as earned would be to return it in a method not followed in keeping the books of account of petitioner.

4. Your petitioner respectfully assigns as error committed by the Honorable, the United States Board of Tax Appeals, in the hearing and determination of the above-entitled matter, the following:

(a) Error in determining that there was any deficiency as to the tax due from petitioner and on account of income of petitioner for the year, 1925, and in failing to find and determine that there was

no deficiency due from petitioner on account of the income and surtax of petitioner with respect to the income of petitioner for the year, 1925.

(b) Error in determining that the Three Thousand Two Hundred Ninety-two and 98/100 Dollars ($3,292.98) deducted by petitioner in computing the said partnership's taxable income for the year, 1925, and deducted on account of liability to return overriding commission income by reason of cancellation of policies, was not a proper deduction.

(c) Error in determining that the figure Three Thousand Two Hundred Ninety-two and 98/100 Dollars ($3,292.98), or any other figure set up as a deduction by reason of liability [80] to return overriding commissions received, by reason of cancellation of policies on the premiums of which said overriding commission was computed, was not a proper deduction and was in substance only a reserve against future contingencies.

(d) Error in determining that however certain it may appear from past experience of a business that contingencies will arise requiring an outlay and return of an income, a procedure of setting up a fund to meet such liability is not countenanced by the taxing statutes.

(e) Error in determining that petitioner's overriding commission income, being a percentage of the premiums of policies written by petitioner, was earned when received, and in determining that the same was not earned over the life of the policy to which the same related, and on the premiums of

which the same was computed and was only so earned.

(f) Error in determining that overriding commission income of petitioner was earned when received and must be returned for the year in which the same was received, and could not be returned as earned over the lives of the policies on the premiums of which the same was computed.

(g) Error in determining that to return overriding commission income on an accrual basis, and to return the same as earned, and to return the same on the basis that it was earned over the life of the policies on the premiums of which it was computed, [81] was to return the income of petitioner by a method different from the method used in keeping the books of petitioner and different from the method shown on the books of petitioner.

(h) As to each of the foregoing determinations specified to have been erroneous, petitioner further specifies that each and every one thereof was unsupported and is unsupported by the evidence.

(i) Error in rejecting petitioner's offer of the reports of the internal revenue agent with respect to the income of petitioner for the year, 1925, being Petitioner's Exhibit No. 18, for identification, and in striking out a portion thereof theretofore received in evidence, and stating that the accounts in connection with the general insurance agency of taxpayer may be said to be kept on an accrual basis.

(j) Error in rejecting evidence offered by petitioner, to wit, Petitioner's Exhibit No. 26 for identification.

(k) Error in rejecting evidence offered by petitioner, to wit, Petitioner's Exhibit No. 28 for identification.

WHEREFORE, petitioner prays:

1. That a record of all of the proceedings herein be made up and certified to the United States Circuit Court of Appeals for the Ninth Circuit, and that this appeal be allowed, and that said court review the action and determination of [82] the United States Board of Tax Appeals in this cause.

2. That it be determined that there is no deficiency due on account of the income tax or surtax of petitioner, and with respect to the income of petitioner for the year, 1925, and that the determination of the United States Board of Tax Appeals in that behalf be vacated.

3. That petitioner be permitted, in returning his income, to return overriding commission income, not as received but as earned.

4. That in the event overriding commission income is not to be returned as earned, that then petitioner, in computing his income for purposes of taxation, be permitted to deduct from gross overriding commission income received in any one year the liability incident thereto, to return a portion thereof on cancellation of policies on the premiums of which the said commission was computed.

5. That the errors hereinbefore assigned be corrected and judgment entered accordingly.

6. For such other, further and different relief as, the premises considered, is proper.

ARTHUR B. DUNNE,
Attorney for Petitioner,
920 Insurance Exchange Building,
San Francisco, California.

KENNETH N. LOGAN,
Accountant for Petitioner,
Balfour Building, San Francisco,
California.

[83] State of California,
City and County of San Francisco,—ss.

Arthur M. Brown, being first duly sworn, deposes and says:

That he is the petitioner named in the foregoing petition; that he has read the foregoing petition, and knows the contents thereof, and that the same is true of his own knowledge, except as to matters therein stated on information or belief, and that as to those matters he believes it to be true; that the same is not filed for purposes of delay, and that he verily believes that he is justly entitled to the relief sought.

ARTHUR M. BROWN.

Subscribed and sworn to before me this 3d day of September, 1931.

[Notarial Seal] KATHRYN E. STONE,
Notary Public in and for the City and County of San Francisco, State of California.
My commission expires March 1, 1933.

[84] Filed Sept. 9, 1931.

United States Board of Tax Appeals.

DOCKET No. 39,157.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

NOTICE OF FILING OF PETITION FOR REVIEW.

To the Honorable, the Commissioner of Internal Revenue, Respondent Above Named, Washington, D. C., and to His Attorney:

You are hereby notified that on the 8th day of September, 1931, petitioner above named filed with the United States Board of Tax Appeals, his petition for review of the decision of the said United States Board of Tax Appeals, in the above-entitled cause, entered herein on the 25th day of April, 1931, redetermining a deficiency in the taxes of petitioner for the year, 1925, by the United States Circuit Court of Appeals for the Ninth Circuit, and that attached hereto is a copy of said petition.

ARTHUR B. DUNNE,
Attorney for Petitioner,
920 Insurance Exchange Building,
San Francisco, Cal.

KENNETH N. LOGAN,
Accountant for Petitioner,
Balfour Building, San Francisco, Cal.

[85] Due service of the foregoing notice and attached copy of petition and receipt of copies thereof, is hereby admitted this 9th day of September, 1931.

_____,

Commissioner of Internal Revenue,
By C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

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[86] Filed Sept. 8, 1931.

United States Board of Tax Appeals.

DOCKET No. 43,432.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW OF DECISION OF UNITED STATES BOARD OF TAX APPEALS BY UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Your petitioner, Arthur M. Brown, feeling himself aggrieved by the decision of the United States Board of Tax Appeals rendered and made herein and entered herein on the 25th day of April, 1931, redetermining a deficiency on the income tax (nor-

mal tax and surtax) of petitioner for the calendar year, 1926, in an amount of Nine Hundred Forty-four and 30/100 Dollars ($944.30), does hereby appeal from said decision and redetermination and does hereby petition that said decision and redetermination be reviewed [87] pursuant to the statutes and rules in such cases made and provided, and in that behalf respectfully shows as follows:

1. Petitioner is an individual, and petitioner is now, and at all times herein mentioned was, residing at San Francisco, State of California, and is now, and at all times herein mentioned was, an inhabitant of the State of California and of the Ninth of the Circuits established for the United States Circuit Courts of Appeals. Petitioner, pursuant to the provisions of law in that behalf made and provided, duly filed with the Collector of Internal Revenue for the First District of California, at San Francisco, California, his return of his income for the calendar year, 1926. Thereafter, the Honorable, the Commissioner of Internal Revenue, respondent herein, assessed against petitioner and on account of the income of petitioner for the calendar year, 1926, a deficiency. Thereafter, and within the time allowed by law, petitioner, feeling himself aggrieved by said determination, did, pursuant to the provisions of law in said cases made and provided, petition the Honorable, the United States Board of Tax Appeals, to review said determination. Respondent herein having appeared and answered said petition said matter did come on duly and regularly to be heard before the said,

the Honorable, the United States Board of Tax Appeals, and thereafter, and on the 11th day of March, 1931, said, the Honorable, the United States Board of [88] Tax Appeals did promulgate and render and file its findings of fact and opinion herein in favor of respondent, and adverse to your petitioner, and thereafter, and upon motion of respondent, for judgment, and on the 25th day of April, 1931, did, in accordance with said findings and opinion, render, make, file and enter herein, its decision and judgment ordering and deciding, upon redetermination, that the deficiency in the tax of petitioner for the year, 1926, is the sum of Nine Hundred and Forty-four and 30/100 Dollars ($944.30).

2. Petitioner hereby seeks review of said determination and decision and judgment by the United States Circuit Court of Appeals for the Ninth Circuit.

3. The nature of the controversy is as follows:

During the year 1926, petitioner and his son, Arthur M. Brown, Jr., as copartners, conducted a general insurance agency business under the fictitious name of "Edward Brown & Sons," and the income of petitioner for the year, 1926, as to which there is a controversy, was the petitioner's share of the income of said partnership derived from "overriding commissions" on account of said business. The business conducted as aforesaid and on behalf of various insurance companies consisted in the management of the business of said companies, and, particularly, in the writing of insurance for them. The policies of insurance for said companies so written during

calendar year, 1926, and for years prior thereto, [89] and after 1926, were policies written for definite terms which said terms were one, three and five years. Part of the compensation paid on account of said services rendered as aforesaid consisted in the payment of a percentage of the premiums collected on such insurance written as aforesaid, which said percentage was determined by the contract between said partnership and the insurance companies represented by it and for whom it acted. This was known as overriding commission. Upon cancellation of any insurance written as aforesaid before the expiration of a term for which the same was written, the unearned portion of the premium for insurance was required to be returned to the assured, and, accordingly, on such cancellation by either the assured or the insurance company, and on the return of such premium, there was required to be refunded such proportion of the overriding commission as the refunded part of the premium bore to the full premium. Long experience showed that the percentage of premiums refunded by reason of cancellation and consequent refund of overriding commission was between 21% and 23% during a given year. In making his return for the year, 1926, petitioner deducted in computing said partnership's net income for that year One Thousand Nine Hundred Forty-seven and 77/100 Dollars ($1,947.77) on account of return which would have to be made from overriding commissions paid by reason of cancellation and consequent return of premium with respect to policies written during

the calendar year, 1926. [90] Such deduction was disallowed by the respondent, and the respondent now claims that the same is improper, by reason of the fact that no reserve can lawfully be set up in such manner, and by reason of the fact that the liability to return unearned overriding commission is contingent only. The books of said partnership for the calendar year, 1926, were kept on an accrual basis. Petitioner further asserts that the services for which said overriding commissions are paid are not completed upon writing of the policies, but extend and are performed throughout the whole of the life of each policy. Petitioner further asserts that if the foregoing method of returning overriding commission income is improper, that then he is entitled to return said income, not on a cash basis and as received, but on an accrual basis and only as earned, and that accordingly, the books being kept on an accrual basis, and his income being a percentage of premiums on policies written during the year 1926, but for terms which will extend beyond 1926, he should return of such income for the year 1926, only such portion thereof as is represented by the life of such policy during the year, 1926, and, consequently, only such portion thereof as is earned during the year 1926; that his said income, being a percentage of premiums earned on policies, is earned only over the life of the policy, as is the premium, and, accordingly, in any one year only such proportion should be returned as corresponds to the life of the policy in said particular year and is earned in said year. Respon-

dent contended that overriding commission [91] income should be returned in the year in which received, irrespective of the nature of the policy or policies on the premiums of which it was computed, and that to return it as earned would be to return it in a method not followed in keeping the books of account of petitioner.

4. Your petitioner respectfully assigns as error committed by the Honorable, the United States Board of Tax Appeals, in the hearing and determination of the above-entitled matter, the following:

(a) Error in determining that there was any deficiency as to the tax due from petitioner and on account of income of petitioner for the year 1926, and in failing to find and determine that there was no deficiency due from petitioner on account of the income and surtax of petitioner with respect to the income of petitioner for the year 1926.

(b) Error in determining that the One Thousand Nine Hundred Forty-seven and 77/100 Dollars ($1,947.77) deducted by petitioner in computing the said partnership's taxable income for the year 1926, and deducted on account of liability to return overriding commission income by reason of cancellation of policies, was not a proper deduction.

(c) Error in determining that the figure One Thousand Nine Hundred Forty-seven and 77/100 Dollars ($1,947.77), or any other figure set up as a deduction by reason of liability [92] to return overriding commissions received, by reason of cancellation of policies on the premiums of which said overriding commission was computed, was not a

proper deduction and was in substance only a reserve against future contingencies.

(d) Error in determining that however certain it may appear from past experience of a business that contingencies will arise requiring an outlay and return of an income, a procedure of setting up a fund to meet such liability is not countenanced by the taxing statutes.

(e) Error in determining that petitioner's overriding commission income, being a percentage of the premiums of policies written by petitioner, was earned when received, and in determining that the same was not earned over the life of the policy to which the same related, and on the premiums of which the same was computed and was only so earned.

(f) Error in determining that overriding commission income of petitioner was earned when received and must be returned for the year in which the same was received, and could not be returned as earned over the lives of the policies on the premiums of which the same was computed.

(g) Error in determining that to return overriding commission income on an accrual basis, and to return the same as earned, and to return the same on the basis that it was earned over the life of the policies on the premiums of which it was computed, [93] was to return the income of petitioner by a method different from the method used in keeping the books of petitioner and different from the method shown on the books of petitioner.

(h) As to each of the foregoing determinations

specified to have been erroneous, petitioner further specifies that each and every one thereof was unsupported and is unsupported by the evidence.

(i) Error in rejecting petitioner's offer of the reports of the internal revenue agent with respect to the income of petitioner for the year 1926, being Petitioner's Exhibit No. 19 for identification, and in striking out a portion thereof theretofore received in evidence, and stating that the accounts in connection with the general insurance agency of taxpayer may be said to be kept on an accrual basis.

(j) Error in rejecting evidence offered by petitioner, to wit, Petitioner's Exhibit No. 26 for identification.

(k) Error in rejecting evidence offered by petitioner, to wit, Petitioner's Exhibit No. 28 for identification.

WHEREFORE, petitioner prays:

1. That a record of all of the proceedings herein be made up and certified to the United States Circuit Court of Appeals for the Ninth Circuit, and that this appeal be allowed, and that said court review the action and determination of [94] the United States Board of Tax Appeals in this cause.

2. That it be determined that there is no deficiency due on account of the income tax or surtax of petitioner, and with respect to the income of petitioner for the year, 1926, and that the determination of the United States Board of Tax Appeals in that behalf be vacated.

3. That petitioner be permitted, in returning his

income, to return overriding commission income, not as received but as earned.

4. That in the event overriding commission income is not to be returned as earned, that then petitioner, in computing his income for the purposes of taxation, be permitted to deduct from gross overriding commission income received in any one year the liability incident thereto, to return a portion thereof on cancellation of policies on the premiums of which the said commission was computed.

5. That the errors hereinbefore assigned be corrected and judgment entered accordingly.

6. For such other, further and different relief as, the premises considered, is proper.

ARTHUR B. DUNNE,
Attorney for Petitioner,
920 Insurance Exchange Building,
San Francisco, California.

KENNETH N. LOGAN,
Accountant for Petitioner,
Balfour Building, San Francisco,
California.

[95] State of California,
City and County of San Francisco,—ss.

Arthur M. Brown, being first duly sworn, deposes and says:

That he is the petitioner named in the foregoing petition; that he has read the foregoing petition, and knows the contents thereof, and that the same is true of his own knowledge, except as to matters therein stated on information or belief, and that as to those matters he believes it to be true; that

the same is not filed for the purposes of delay, and that he verily believes that he is justly entitled to the relief sought.

ARTHUR M. BROWN.

Subscribed and sworn to before me this 3d day of September, 1931.

[Notarial Seal] KATHRYN E. STONE,
Notary Public in and for the City and County of San Francisco, State of California.
My commission expires March 1, 1933.

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[96] Filed Sept. 9, 1931.

United States Board of Tax Appeals.

DOCKET No. 43,432.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

NOTICE OF FILING OF PETITION FOR REVIEW.

To the Honorable Commissioner of Internal Revenue, Respondent Above Named, Washington, D. C., and to His Attorney:

You are hereby notified that on the 8th day of September, 1931, petitioner above named filed with the United States Board of Tax Appeals, his petition

for review of the decision of the said United States Board of Tax Appeals, in the above-entitled cause, entered herein on the 25th day of April, 1931, redetermining a deficiency in the taxes of petitioner for the year 1926, by the United States Circuit Court of Appeals for the Ninth Circuit, and that attached hereto is a copy of said petition.

ARTHUR B. DUNNE,
Attorney for Petitioner,
920 Insurance Exchange Building,
San Francisco, California.

KENNETH N. LOGAN,
Accountant for Petitioner,
Balfour Building, San Francisco,
California.

[97] The service of the foregoing notice and attached copy of petition and receipt of copies thereof is hereby admitted this 9th day of September, 1931.

_____,
Commissioner of Internal Revenue.
By C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

[98] Filed Jan. 21, 1932.

United States Board of Tax Appeals.

Three proceedings, entitled as here, and numbered respectively as follows:

DOCKET No. 35,305.
DOCKET No. 39,157.
DOCKET No. 43,432.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

CONSOLIDATED STATEMENT OF EVIDENCE.

BE IT REMEMBERED that the petitioner above named having filed with the United States Board of Tax Appeals three separate petitions for determination of the tax liability of petitioner to the United States of America on account of the normal income tax and surtax of petitioner for the years 1923, 1925 and 1926, which said petitions and proceedings started thereby were entitled as above, and numbered on the files of the said United States Board of Tax Appeals respectively, Docket Nos. 35,305, 39,157 and 43,432; and respondent above named having filed his separate answer to each of said petitions, said three causes came on duly and regularly to be heard before the said United States

Board of Tax Appeals, Honorable John J. [99] Marquette, Member, presiding, at San Francisco, California, on the 14th day of May, 1930 petitioner appearing in person and by Arthur B. Dunne, Esq., his attorney, and Mr. Kenneth N. Logan, C. P. A., and respondent appearing by his attorneys, Clarence M. Charest, Esq., General Counsel, Bureau of Internal Revenue, and Eugene Meacham, Esq. Thereupon, on motion of counsel for petitioner, and by consent of counsel for respondent, it was ordered that said three causes be consolidated for hearing and decision. Thereafter, and on the 11th day of March, 1931, the United States Board of Tax Appeals promulgated and filed herein its findings of fact and opinion in said three causes, in favor of respondent and adverse to petitioner, and thereafter, and on the 25th day of April, 1931, on motion of respondent for judgment in accordance therewith, entered in each of said causes its decision and judgment in accordance with said findings of fact and opinion. Thereafter, by stipulation between the parties, said stipulation being in writing and being filed in each of said causes, it was stipulated that should petitioner above named perfect an appeal from said decisions, and to the United States Circuit Court of Appeals for the Ninth Circuit, that then said three causes be consolidated on appeal, and that petitioner for review need prepare and file but one statement of evidence as incident to said appeal and the preparation of a record therefor, which said statement of evidence should serve and be considered in all of said [100] three causes.

Accordingly, and the petitioner having heretofore duly served and filed his petitions for review of said decisions aforesaid, and his notice of filing of said petitions for review, in each of said three named causes, presents this his consolidated statement of evidence in said causes as follows:

Said causes coming on to be heard as aforesaid and having been consolidated as aforesaid, the following proceedings and none other were had, and the following evidence and none other was introduced, and the following is a full, true and correct statement of all matters, happenings and showings before the United States Board of Tax Appeals on its hearing and determination of said causes, and each of them, excepting only the pleadings in said causes, respectively:

Counsel for petitioner made an opening statement as to what petitioner expected to prove, and in the course of said statement stated that one of the items in controversy was a deduction made by petitioner from the income of petitioner, which deduction was a figure representing the liability of petitioner to return overriding commission received by reason of cancellation of policies on the premiums of which the commission had been computed, and it was stipulated that 1923 was the first year in which this was done. Counsel for respondent then made an opening statement, and petitioner then offered and introduced the following evidence:

TESTIMONY OF W. H. GIBBONS, FOR PETITIONER.

[101] W. H. GIBBONS, called as a witness on behalf of petitioner, being first duly sworn, testified as follows:

Direct Examination by Mr. DUNNE.

Edward Brown & Sons, up to 1922, was a partnership composed of Arthur M. Brown and his brother, Herbert H. Brown. Thereafter, for a short time, it was Arthur M. Brown, doing business under the name of Edward Brown & Sons, and thereafter was a partnership of Arthur M. Brown and his son, Arthur M. Brown, Jr. During 1918 and following I was with that organization as Superintendent of Agencies, became Assistant General Agent, and I was in charge of the underwriting department. I am familiar with the form of policies written by the companies represented by Edward Brown & Sons throughout the territory represented by them. In California the fire policy used is the California Standard Form, exclusively. In Oregon fire inance is written on the Oregon Standard Fire Insurance Policy. We use the old New York Standdard Form in Washington, Montana, Utah and Nevada, and the new New York Standard Form in Wyoming, Colorado, New Mexico, the Hawaiian Islands and Alaska. Of these forms now shown me the one on top is the old New York Standard Form and the second one is the California form. The conditions on the Oregon policy are the old New

(Testimony of W. H. Gibbons.)

York form. With reference to the part [102] of the policy as to cancellation there has been no change in those provisions in the policies written by Edward Brown & Sons since 1917; no change as to calculating the return premium, nor with respect to the right of the assured to cancel, nor with respect to the right of the insurance company to cancel. They all contain the provision that the assured can cancel upon the customary short rate. These policies are all cancellable either by the assured on the short rate basis or by the company on the prorated basis.

Thereupon, the three policies referred to were offered and received in evidence as Petitioner's Exhibit No. 1, were so marked, and so far as they are material here were and are as follows:

PETITIONERS' EXHIBIT No. 1.

"STOCK COMPANY

"STANDARD FIRE INSURANCE POLICY.

"The Globe & Rutgers Fire Insurance Company * * * In consideration of the stipulations herein named and of ——— Dollars premium does insure ——— for the term of ——— * * * against all direct loss or damage by fire, except as hereinafter provided, to an amount not exceeding ——— Dollars to the following described property while located and contained as described herein, and not elsewhere, to-wit:

(Space for Description.)

"This policy is made and accepted subject to the

foregoing stipulations and conditions, and to the following stipulations and conditions printed on back hereof, which are hereby specifically referred to and made a part of this policy, * * * ."

(Here appears the company's signature and countersignature of agent.)

[103] Printed on the back of said policy appeared the following:

" * * * *

"This policy shall be cancelled at any time at the request of the insured; or by the company by giving five days notice of such cancellation. If this policy shall be cancelled as hereinbefore provided, or become void or cease, the premium having been actually paid, the unearned portion shall be returned on surrender of this policy or last renewal, this company retaining the customary short rate; except that when this policy is cancelled by this company by giving notice it shall retain only the *pro rata* premium.

" * * * * "

"CALIFORNIA

"STANDARD FORM FIRE INSURANCE POLICY.

" * * * *

"The Globe & Rutgers Fire Insurance Company * * * In consideration of the stipulations herein named and of ——— Dollars premium does insure ——— for the term of ——— * * * against all loss or damage by fire, except as hereinafter provided, to an amount not exceeding ———

Dollars to the following described property while located and contained as described herein, and not elsewhere, to-wit:

(Space for Description.)

" * * *

"This policy is made and accepted subject to the foregoing stipulations and conditions and those hereinafter stated, which are hereby specifically referred to, and made part of this policy, * * * ."

(Here appears the company's signature and countersignature of agent.)

[104] Printed on the back of said policy appeared the following:

"STIPULATIONS AND CONDITIONS SPECIALLY REFERRED TO.

" * * *

"Cancellation. This policy shall be cancelled at any time at the request of the insured, in which case the company shall, upon surrender of this policy, refund the excess of paid premium above the customary short rates for the expired time. This policy may be cancelled at any time, without tender of unearned portion of premium, by the company by giving five (5) days' written notice of cancellation to the insured and to any mortgagee or other party to whom, with the written consent of the company, this policy is made payable, in which case the company shall, upon surrender of the policy or relinquishment of liability thereunder, re-

fund the excess of paid premium above the *pro rata* premium for the expired time.

" * * * * "

On outside back cover—

"OREGON

"STANDARD FIRE INSURANCE POLICY.

Body of Policy—

" * * * *

"The Globe & Rutgers Fire Insurance Company * * * In consideration of the stipulations herein named and of ——— Dollars premium does insure ——— for the term of ——— * * * against all direct loss or damage by fire, except as hereinafter provided, to an amount not exceeding ——— Dollars to the following described property while located and contained as described herein, and not elsewhere, to wit:

(Space for Description.)

[105] "This policy is made and accepted subject to the foregoing stipulations and conditions, and to the following stipulations and conditions printed on the back hereof, which are hereby specially referred to and made a part of this Policy, * * * "

(Here appears the company's signature and countersignature of agent.)

Printed on the back of said policy appeared the following:

" * * * *

"This policy shall be canceled at any time at the request of the insured; or by the company by giv-

(Testimony of W. H. Gibbons.)

ing five days notice of such cancellation. If this policy shall be canceled as hereinbefore provided, or become void or cease, the premium having been actually paid, the unearned portion shall be returned on surrender of this policy or last renewal, this company retaining the customary short rate; except that when this policy is canceled by this company by giving notice it shall retain only the *pro rata* premium.

" * * * * "

It is prayed that the original of said Exhibit 1 be forwarded to the United States Circuit Court of Appeals for the Ninth Circuit with the record herein.

WITNESS.—(Continuing.) This paper which I have is another form of policy used in Mexico and the Philippine Islands.

[106] Thereupon the policy referred to was offered and received in evidence as Petitioner's Exhibit No. 2, was so marked, and so far as it is material here was and is as follows:

PETITIONER'S EXHIBIT No. 2.

"STOCK COMPANY.

"The Globe & Rutgers Fire Insurance Company * * *

"This policy of insurance Witnesseth, that ——— (hereinafter called the insured) having paid to the Globe and Rutgers Fire Insurance Company of New York (hereinafter called the Company) the sum of ——— ——— for such insurance as

hereinafter mentioned, of the Property hereinafter described, in the Sum or Several Sums following, viz.:—

(Space for Description.)

"The Company hereby agrees with the insured, subject to the Conditions expressed in and endorsed upon this Policy and which are to be taken as part hereof, that if the Property hereinbefore described, or any part thereof, shall be destroyed or damaged by Fire between the ——— * * * ."

(Here appears the company's signature and countersignature of agent.)

Printed on the back of said policy appeared the following:

"The Conditions Referred to in This Policy are as Follows:

" * * *

"9. The Insurance may be terminated at any time at the request of the Insured, in which case the Company will retain the customary short period rate for the time the Policy has been in force. The Insurance may also at any time be terminated at the option of the Company, on [107] "notice to that effect being given to the Insured, in which case the Company shall be liable to repay on demand a ratable proportion of the premium for the unexpired term from the date of the cancelment.

" * * * * "

It is prayed that the original of said Exhibit 2 be forwarded to the United States Circuit Court of Appeals for the Ninth Circuit with the record herein.

Thereupon counsel for petitioner stated that the British Columbia form of policy is provided for by the Insurance Act of the Province of British Columbia, being Chapter 20 of British Columbia Statutes of 1925, as amended by Chapter 35 of said statutes for 1926–1927, and Chapter 19 of said Statutes for 1928, and was permitted to read into the Record subdivision 10 of Section 142 thereof, as follows:

"(1) Insurance may be terminated:

"(a) Subject to the provision of condition 9, by the insurer giving to the insured at any time fifteen days' notice of cancellation by registered mail or five days' notice of cancellation personally delivered, and, if the insurance is on the cash plan, refunding the excess of the premium actually paid by the insured beyond the *pro rata* premium for the expired term;

"(b) If on the cash plan by the insured giving written notice of termination to the insurer, in which case the insurer shall, upon surrender of this policy [108] refund the excess of premium actually paid by the insured beyond the customary short rate for the expired time.

"(2) Repayment of the excess premium may be made by money, post office order or postal note or by cheque payable at par and certified by a chartered bank doing business in the Province. If the notice is given by registered letter, such repayment shall accompany the notice, and in such case the fifteen days mentioned in clause (a) of this condition shall commence to run from the day

(Testimony of W. H. Gibbons.)

following the receipt of the registered letter at the post office to which it is addressed."

WITNESS.—(Continuing.) Brown & Sons wrote marine insurance. Cargo insurance is not cancellable but ceases when the voyage is finished. The premium is considered earned when the voyage begins, and after the voyage is once started the risk is attached, there is no cancellation, no return premium, and no return commission.

TESTIMONY OF ARTHUR M. BROWN, ON HIS OWN BEHALF.

ARTHUR M. BROWN, petitioner, called as a witness on his own behalf, being first duly sworn, testified, as follows:

Direct Examination by Mr. DUNNE.

My name is Arthur M. Brown. I am the petitioner. I am the senior partner of the firm of Edward Brown & Sons, general insurance agents.

[109] The difference between local agents and general agents is that a local agent is the solicitor, the man who directly gets the business, and the general agent is the one who underwrites it for the companies, an insurance wholesaler.

I first engaged in business with Edward Brown & Sons, and became a proprietary member of the organization in 1896, and have been in that business continuously since. The agency arrangements of Edward Brown & Sons were changed to provide

(Testimony of Arthur M. Brown.)

for an overriding commission about 1900. Before that time the firm had been operating on a flat commission scale of compensation out of which it paid to the local agents of the companies the commissions due them. That was changed to an arrangement whereby we were authorized to directly pay the commission to the agents, and we, instead of participating in a flat commission, were compensated by an overriding commission, over and above the commission paid to the local agents and brokers. If we were on a flat commission basis, and the rate of commission of the local agents and brokers was raised, that would cut the income down in proportion—in proportion that the increase bore to the original compensation commission. That is not true under the overriding commission plan. The company pays changes in the rates of local agents, and we receive the same scale of overriding commission.

The rate of commission for local agents is fixed by the Board of Fire Underwriters of the city, and our compensation is [110] fixed by agreement with the companies.

From 1896 to 1904, when my father died, the firm of Edward Brown & Sons consisted of my father, myself and my brother. This paper handed to me dated San Francisco, June 1, 1902, is the agreement between the partners as to the division of the earnings of the firm, subject to a payment to the three daughters of my father. Thereupon the document referred to was offered and received

in evidence as Petitioner's Exhibit No. 3, was so marked, and is as follows:

PETITIONER'S EXHIBIT No. 3.

"San Francisco, June 1st, 1902.

"Edward Brown, Arthur M. Brown and Herbert H. Brown, doing business under the firm name of EDWARD BROWN & SONS, as General Agents of Fire Insurance Companies, at 411–413 California, Street, San Francisco, in the State of California, hereby agree and declare their respective interests in such business to be as follows;

"After First setting apart and paying the sum of Two Hundred and Fifty Dollars ($250) per month as hereinafter provided for, the remaining profits to be divided as follows:

"EDWARD BROWN to have four-tenths;

"ARTHUR M. BROWN to have four-tenths;

"HERBERT H. BROWN to have two-tenths.

"Bad debts and all other losses connected with the business to be borne by the several parties in like proportions.

"Before any division of profits is made the said partners mutually agree to pay monthly to Jessie H. Jones, Edith H. Halton and Ethel Brown, (the three daughters of Edward Brown and Sisters of Arthur M. and Herbert H. Brown) [111] the sum of Two Hundred and Fifty Dollars (250) and Further, that whenever the net income from the business of the said firm shall exceed the sum of Eighteen Thousand Dollars per annum they will pay a one-sixth proportion of such excess to the

(Testimony of Arthur M. Brown.)

said Jessie H. Jones, Edith H. Halton and Ethel Brown.

"They further agree that in the case of the Death of one or more members of the said firm his or their heirs or executors shall be paid annually, for a term not exceeding ten years from the date of the death of such member or members, such proportion of the net profits of said firm as hereinafter is proportion (provided),

"To the heirs or executors of EDWARD BROWN One-tenth;

"To the heirs or executors of ARTHUR M. BROWN two-tenths;

"To the heirs or executors of HERBERT H. BROWN one-tenth;

"PROVIDED that should Herbert H. Brown die before marrying no payment shall be required to be made to his heirs or executors.

"It is further agreed that monthly installments on account of the said proportionate interest or interests shall be made on demand to such heirs or executors.

"Witness our hands the date and place above mentioned.

"EDWARD BROWN.
"ARTHUR M. BROWN.
"HERBERT H. BROWN."

WITNESS.—(Continuing.) This paper handed to me and dated May 28th, 1907, was a substitution for the previously dated agreement between my two sisters, my oldest sister having died in the

(Testimony of Arthur M. Brown.)

meantime. The signatures at the foot of the instrument are the [112] signatures of my sisters, Edith Halton and Ethel Crandell. That agreement has never been modified or changed by any subsequent writing. It refers to an agreement dated in 1905. I have searched for that agreement, and have been unable to find it.

Thereupon the document referred to was offered and received in evidence as Petitioner's Exhibit No. 4, was so marked, and is as follows:

PETITIONER'S EXHIBIT No. 4.

"We, Edith H. Halton and Ethel Crandell, the undersigned, and each of us, and the survivor of us, do and does hereby consent and agree to accept from the firm of Edward Brown & Sons, General Fire Insurance Agents, San Francisco, California, the sum of Two Hundred and fifty (250) dollars per month, commencing with the month beginning June 1st, 1907, and ending only by mutual agreement in full satisfaction of all amounts which may be due, or may become due, to us, or either of us, or to the survivor of us, from said firm, under and by reason of the provisions of that certain Agreement dated May 27th, 1905, by and between Arthur M. Brown and Herbert H. Brown, as surviving members of said firm and as Heirs, and as Executors of the Will, of Edward Brown, deceased; Henry Michaels, as Executor of said Will; and Jessie H. Jones, Edith H. Halton and Ethel Crandell, as Heirs, and as residuary legatees and devisees under the Will, of Edward Brown, deceased; and Irene

(Testimony of Arthur M. Brown.)

W. Brown, as widow and an Heir, and as a legatee under the Will, of Edward Brown, deceased: Provided that any further amounts to which we, or either of us, or the survivor of us, might be entitled from said firm under said Agreement shall be retained in the net profits of said firm as the property and to the credit of said Arthur M. Brown and Herbert H. Brown, members of said firm, to be divided between them as they may agree.

"Witness our hands this 28th day of May, A. D. 1907.

"EDITH H. HALTON.
"ETHEL CRANDELL.

"Witness:
"W. H. WATSON
"FREDERICK C. BROWN"

[113] WITNESS.—(Continuing.) My father died in 1904. From 1904 to 1922 the directors of the business of Edward Brown & Sons were my brother and myself. Our interests were 60% to me and 40% to my brother, and expenses were borne and profits shared in that relation, subject to this written agreement which has been introduced in evidence. After 1907 there was no change in the proprietorship of that business until my brother's death in August, 1922. After that there was no person other than myself, with the exception of my sisters, under this written agreement, who had any proprietorship in the business until, eventually, my son, Arthur M. Brown, Jr., was admitted as a partner in the business. I think

(Testimony of Arthur M. Brown.)

there was a written agreement of partnership between myself and my son, but I do not recall when it was executed. The effective date of my son's participation was January 1, 1924; and his first participation was 25%, and it was subsequently changed and he has a 40% interest.

This paper handed to me dated June 1, 1920, is the agreement of the terms of the general agency between the Svea and Edward Brown & Sons, that is my brother and myself. The endorsements attached are the recognition of myself as the general agent of the company on my brother's death, and later the recognition of my son as a partner under the same firm title of Edward Brown & Sons.

[114] Thereupon the document referred to, together with the two endorsements referred to, together with a third endorsement entitled "Amendment No. 3," was offered and received in evidence as Petitioner's Exhibit No. 5, and was so marked. Subsequently, copies of said original documents were substituted for said originals and marked Exhibit 5, and said originals and copies were and are as follows:

PETITIONER'S EXHIBIT No. 5.

[115] "This Agreement, made this First (1st) day of June, One Thousand Nine Hundred and Twenty (1920), by and between the BRAND— & LIFFORSAKRINGS AKTIEBOLAGET SVEA, also known as the SVEA FIRE AND LIFE INSURANCE COMPANY, LIMITED, OF GOTH-

ENBURG, SWEDEN, party of the first part, and ARTHUR M. BROWN and HERBERT H. BROWN, as copartners constituting the firm of EDWARD BROWN & SONS, OF SAN FRANCISCO, CALIFORNIA, parties of the second part, Witnesseth;—

"I.

"Whereas said parties have been operating under an agreement made the First (1st) day of June, One Thousand Nine Hundred and Thirteen (1913), and it is now desired to make a new agreement, it is agreed that the said agreement of Nineteen Hundred and Thirteen (1913) shall be discontinued, except in so far as it applies to matters now pending under same.

"II.

"Party of the first part hereby continues the appointment of parties of the second part as its General Agents for the following

"TERRITORY.

"The States of

ARIZONA,
CALIFORNIA,
COLORADO,
IDAHO,
MONTANA,
NEVADA,
NEW MEXICO,
OREGON,
UTAH,
WASHINGTON,
WYOMING,

"The Territories of

ALASKA,

HAWAII and

"The Province of

BRITISH COLUMBIA,

and such other territory as may hereafter be agreed upon, with full authority to appoint and remove agents; to accept service of process for the SVEA FIRE AND LIFE INSURANCE COMPANY; to adjust and pay losses under the policies of said Company; to receive and acknowledge service of Proofs of Loss; to issue, countersign and cancel its policies and to receive and receipt for premiums thereon, and to transact such other business as usually pertains to a General Agency of a Fire Insurance Company.

[116] "Parties of the second part accept the appointment; agree to faithfully perform the duties which usually devolve upon General Agents; to use their best endeavors on behalf of said party of the first part; to promptly obey such instructions as they may, from time to time, receive and to conduct their agency in accordance with the rules and regulations of the Rating Organizations operating in said territory when not in conflict with law. Parties of the second part shall be liable for the consequences of any wilful violations made by them of instructions received by them from party of the first part.

"III.

"PAYMENT OF PREMIUMS.

"Parties of the second part guarantee the pay-

ment to the party of the first part of all premiums on policies issued by them or their agents, and shall in no case be entitled to credit by reason of their failure to collect said premiums from their agents or from the assured.

"IV.

"REINSURANCE.

"Said parties of the second part are authorized to accept lines in excess of the amounts provided for in the General Instructions of the party of the first part, provided such excess lines are immediately reinsured by parties of the second part with the Treaty Companies of the party of the first part. Should further reinsurance be necessary of amounts in excess of the aggregate amount of the retentions of the party of the first part and its Treaty Companies, such reinsurance shall also be immediately effected by parties of the second part in Companies acceptable to the party of the first part.

"On risks which are of such desirable character that the party of the first part carries at least 1.000:— net, an equal amount to the net retention of the party of the first part may be transferred to the 'Home Office Account.'

"V.

"COMPENSATION.

"Party of the first part will allow parties of the second part commencing from June First (1st) One Thousand Nine Hundred and Twenty (1920), as compensation for their services, an overriding commission of Fifteen (15%) per cent. upon such

premiums (less return and reinsurance premiums) on which the local agency [117] commission under the rules of the Pacific Board of Fire Underwriters is Fifteen (15%) per cent., and an overriding commission of Twelve and one-half (12½%) per cent. upon the premiums (less return and reinsurance premiums) of all other business.

"Party of the first part shall pay, through parties of the second part, all brokerages and commissions, Government and State taxes, licenses and fees and assessments for the maintenance of Rating Associations and Fire Patrols.

"Party of the first part hereby agrees to pay the parties of the second part the amounts of contingent commissions actually allowed the local agents representing the party of the first part in the Territory of Hawaii, the Province of British Columbia and the General and Farm Agents for the State of Colorado.

"Parties of the second part shall also be allowed to charge all actual expenses (according to vouchers to be rendered with the monthly statements) for policy, daily report, endorsement and other blanks necessary to the reporting of the business to the party of the first part; for office and outside signs furnished by the parties of the second part to their sub-agents or brokers; for advertising blotters and for disbursements for postal and telegraph expenses in direct service to the party of the first part or its United States Manager at New York.

"Parties of the second part shall not be entitled to charge the party of the first part for any other expenses, save that it is understood and agreed that the parties of the second part shall also be allowed all actual expenses of litigation incurred on behalf of the party of the first part in connection with any business done by the said parties of the second part under this agreement, and also all actual expenses incurred in adjustment, investigation and settlement of losses, including the guarding and handling of damaged property and effecting salvages, on business done by the parties of the second part under this agreement, according to vouchers which are to be kept on file by parties of the second part and held at the disposal of the party of the first part.

"The overriding commissions set forth are to be based upon the net lines set forth in the General Instructions of June Eighth (8th) One Thousand Nine Hundred and Twelve (1912) and are also to apply to lines transferred to the 'Home Office Account.'

"It is understood and agreed that on the business ceded to the Treaty Companies the parties of the second part shall be allowed an overriding commission of Seven and one-half (7½%) per cent. on the Fifteen (15%) per cent. business and Five (5%) per cent. on all other business, or, in other words, 7½% less overriding [118] commission than allowed on the business actually retained for own account and transferred to the 'Home Office Account' of the party of the first part.

"It is further understood and agreed that on the business hitherto transferred to the 'Special Account' the parties of the second part shall be allowed 5% less overriding commission than on the business retained for own account and transferred to the 'Home Office Account' of the party of the first part.

"VI.

"CONTINGENT COMMISSION.

"Party of the first part further agrees to pay the parties of the second part a further compensation of Fifteen (15%) per cent. contingent commission on the net profits of the General Business and the 'Home Office Account,' the net profit to be calculated as follows:

"As INCOME:

"1. Premium reserve from previous year.

"2. Losses unsettled and pending from preceding years with deduction of reinsurance and 'Special Account' proportions.

"3. Amounts of premiums written during the year, with deduction for return premiums and reinsurance as well as 'Special Account' premiums.

"As EXPENDITURE:

"1. Commission and all expenses allowed under this agreement, with deduction of an amount equal to 25% on the net business ceded to the Treaty Companies and 32½% on the net business transferred to the 'Special Account.'

"2. Such proportion of expenses in connection with the United States Trustees of the party of the first part and financial transactions with the named United States Trustees through the New York Department of the party of the first part as the yearly premium income from the General Agency of the parties of the second part bears toward the premium income of the entire United States business of the party of the first part.

"3. All losses paid during the year, with deductions for reinsurance and 'Special Account' proportions.

[119] "4. All outstanding and unpaid losses at the end of the fiscal year, with deduction for reinsurance and 'Special Account' proportions.

"5. Forty (40%) per cent. premium reserve on the net premiums written during the year, with deduction for return premiums and reinsurance as well as 'Special Account' premiums.

"Should there be a net loss instead of a net profit shown by any such statement the amount of such loss shall not be charged in any subsequent statement in ascertaining the net profit for any subsequent period.

"VII.

"RATE WAR.

"In case of a general reduction in rates to such

a figure that party of the first part is unwilling to accept the business offered and its policies are surrendered by the assured, it is agreed that the earned premiums will be computed at short rates, that parties of the second part will as far as possible require agents and brokers to charge back return commissions, and party of the first part will allow return commissions to be charged to it on same basis as is allowed to agents and brokers by parties of the second part. The parties of the second part will not be required to refund their overriding commission on policies thus cancelled.

"VIII.

"BOND.

"The parties of the second part shall furnish to the party of the first part a bond of the Fidelity & Casualty Co., of New York, in the sum of Twenty Thousand Dollars ($20,000.) for their faithful performance of this agreement and for payment to the party of the first part of all amounts due from parties of the second part to the party of the first part.

"IX.

"TERMINATION OF CONTRACT.

"This agreement shall govern all business done by the parties of the second part hereunder, unless changed by mutual agreement of the parties hereto, but this agreement may be terminated at any time by either party giving the other ninety (90) days' notice in writing or by cablegram, at the expira-

tion of which time this contract shall cease and determine.

[120] "In case the party of the first part should desire to withdraw from or terminate its business in any of the States and/or Territories embraced in this agreement it may do so by giving ninety (90) days' notice in writing or by cablegram to the parties of the second part, who shall under such notice, provided the party of the first part so instructs the parties of the second part, reinsure such business in a company satisfactory to the party of the first part or cancel same. In case the party of the first part so desires, such business may remain on the books and be allowed to run off to expiration.

"The party of the first part shall bear the expenses which are necessary to effect the termination of the business in question, i. e. traveling expenses of Special Agents in closing local agencies, as well as telegrams and postage in connection therewith. In case of cancellation of the business as above set forth, the parties of the second part shall not be responsible for return commissions, except such portions as are collected from local agents on canceled policies belonging to the business in question. In case the business is reinsured, the whole commission obtained from the reinsuring company belongs to the party of the first part, and in computing the contingent, if any, due the parties of the second part for the year of such withdrawal, the gross reinsurance premiums, or the gross return premiums occa-

sioned by such withdrawal are to be charged against the parties of the second part.

"IN WITNESS WHEREOF, the said party of the first part has caused these presents to be executed in duplicate by its President and one member of The Board and its Corporate Seal to be hereunto affixed, and the parties of the second part have hereunto attached their firm name and affixed Seal.

"Gothenburg, May 17th, 1920.

"BRAND:- OCH LIFFORSAKRINGS—
AKTIEBOLAGET SVEA,
"CARL KINDAL,
"THEODOR HYKANDS.

[121] "AMENDMENT No. 3

to the Contract, made the first (1st) day of June, One Thousand Nine Hundred and Twenty (1920), by and between the BRAND— & LIFFORSAKRINGS-AKTIEBOLAGET SVEA, also known as the SVEA FIRE AND LIFE INSURANCE COMPANY, LIMITED, of Gothenburg, Sweden, party of the first part, and ARTHUR M. BROWN and ARTHUR M. BROWN, Jr., as copartners constituting the firm of EDWARD BROWN & SONS, of San Francisco, California, parties of the second part.

"IT IS HEREBY UNDERSTOOD AND AGREED that the following changes of the above-mentioned contract are made to take effect as of January first (1st), One Thousand Nine Hundred and Twenty Six (1926), viz:

"ARTICLE V.

"COMPENSATION.

"Paragraph seven (7) of this Article is changed to read:

"'It is understood and agreed that on business ceded to the Treaty Companies the parties of the second part shall be allowed an overriding commission of Nine and one-half (9½%) per cent. on the fifteen (15%) per cent. business and Seven (7%) per cent. on all other business or, in other words, 5½% less overriding commission than allowed on the business actually retained for own account and transferred to the "Home Office Account" of the party of the first part.'

"Paragraph eight (8) is hereby revoked on account of the discontinuance of the 'Special Account.'

"ARTICLE VI.

"CONTINGENT COMMISSION

"All prescriptions in this Article bearing upon the 'Special Account' are hereby revoked, following the discontinuance of the 'Special Account.'

"IN WITNESS WHEREOF, the said party of the first part has caused these presents to be executed in duplicate by its President and one member of the Board and its Corporate Seal to be hereunto

affixed, and the parties of the second part have hereunto attached their firm name and affixed Seal.

"Gothenburg, April 22, 1926.

"BRAND— & LIFFORSAKRINGS AK-TIEBOLAGET SVEA,

(Seal) "CORNELIUS PINEUS.

"THEODORE HYKANDS.

[122] "AMENDMENT

to the Contract, made the first (1st) day of June, One Thousand Nine Hundred and Twenty (1920), by and between the BRAND— & LIFFORSAK-RINGS AKTIEBOLAGET SVEA, also known as the SVEA FIRE AND LIFE INSURANCE COMPANY, LIMITED, of Gothenburg, Sweden, party of the first part, and ARTHUR M. BROWN and HERBERT H. BROWN, as copartners constituting the firm of EDWARD BROWN & SONS, of San Francisco, California, parties of the second part.

"I.

"IT IS HEREBY AGREED that the named contract from January first (1st), One Thousand Nine Hundred and Twenty-three (1923), shall be constituted as made by and between the BRAND— & LIFFORSAKRINGS AKTIEBOLAGET SVEA, also known as the SVEA FIRE AND LIFE INSURANCE COMPANY, of Gothenburg, Sweden, party of the first part, and ARTHUR M. BROWN, Sr., and ARTHUR M. BROWN, Jr., doing business under the firm name of EDWARD

BROWN AND SONS, of San Francisco, California, parties of the second part.

"IN WITNESS WHEREOF, the said party of the first part has caused these presents to be executed in duplicate by its President and one member of the Board and its Corporate Seal to be hereunto affixed, and the parties of the second part have hereunto attached their firm name and affixed seal.

"Dated, August 30th, 1923.

"CARL KINDAL.

"THEODOR HYKANDS.

[Seal] "ARTHUR M. BROWN,

Of and for Edward Brown Sons.

[123] "AMENDMENT

to the Contract, made the first (1st) day of June, One Thousand Nine Hundred and Twenty (1920), by and between the BRAND— & LIFFORSAKRINGS AKTIEBOLAGET SVEA, also known as the SVEA FIRE AND LIFE INSURANCE COMPANY, LIMITED, OF GOTHENBURG, SWEDEN, party of the first part, and ARTHUR M. BROWN and HERBERT H. BROWN, as copartners constituting the firm of EDWARD BROWN & SONS, OF SAN FRANCISCO, CALIFORNIA, parties of the second part.

"I.

"IT IS HEREBY AGREED that the named contract from August First (1st), One Thousand

(Testimony of Arthur M. Brown.)

Nine Hundred and Twenty two (1922), shall be considered as made by and between the BRAND— & LIFFORSAKRINGS AKTIEBOLAGET SVEA, also known as the SVEA FIRE AND LIFE INSURANCE COMPANY, OF GOTHENBURG, SWEDEN, party of the first part, and ARTHUR M. BROWN, doing business under the firm of EDWARD BROWN AND SONS, OF SAN FRANCISCO, CALIFORNIA, party of the second part.

"IN WITNESS WHEREOF, the said party of the first part has caused these presents to be executed in duplicate by its President and one member of the Board and its Corporate Seal to be hereunto affixed, and the party of the second part has hereunto attached his firm name and affixed Seal.

"Gothenburg, September 12:th 1922

"BRAND— OCH LIFFORSAKRINGS-AKTIEBOLAGET SVEA.

[Seal] "A. W. HITMAN.

"THEODOR HYKANDS."

[124] WITNESS.—(Continuing.) This paper writing now shown to me dated January, 1911, purporting to be between the Agricultural Insurance Company of Watertown, New York, and Arthur M. Brown and Herbert H. Brown, is the general agency agreement between the Agricultural Insurance Company and our firm, and the endorsements respectively recognize me as the sole member of the firm of Edward Brown & Sons, and my son as my partner in that firm.

(Testimony of Arthur M. Brown.)

Thereupon the documents referred to were offered and received in evidence as Petitioner's Exhibit No. 6, and were so marked. Subsequently, copies of said original documents were substituted for said originals and marked Exhibit 6, and said originals and copies were and are as follows:

PETITIONER'S EXHIBIT No. 6.

[125] "THIS AGREEMENT made this first day of January, 1911, between the AGRICULTURAL INSURANCE COMPANY of Watertown, New York, party of the first part, and ARTHUR M. BROWN and HERBERT H. BROWN, constituting the firm of EDWARD BROWN & SONS of San Francisco, California, parties of the second part,

"WITNESSETH:

"FIRST—Whereas said parties have been operating under an agreement made August 11, 1897, and it is now desired to make a new agreement, it is agreed that said agreement of 1897 shall be discontinued, except in so far as it applies to matters now pending under same.

"TERRITORY.

"SECOND—Party of the first part hereby continues the apointment of parties of the second part as its General Agents for the following territory:

"Arizona
"California
"Washington
"Montana

"Idaho
"Oregon
"Nevada
"New Mexico
"Hawaii
"British Columbia

"and such other territory as may hereafter be agreed upon, with authority to appoint and remove agents, to issue and cancel policies, to collect premiums, to adjust and pay losses and to transact such other business as usually pertains to a General Agency of a Fire Insurance Company.

"Parties of the second part accept the appointment and agree faithfully to perform the duties which usually devolve upon General Agents; to use their best endeavors in behalf of said party of the first part; to promptly obey such instructions as they may, from time to time, receive and to conduct their agency in accordance with the rules and regulations of the rating organizations operating in said territory when not in conflict with law.

[126] "BOND.

"THIRD—Parties of the second part agree to furnish a BOND in the sum of Twelve Thousand Dollars ($12,000), with sureties satisfactory to the party of the first part, for the faithful performance of their duties and for the payment to the party of the first part of all amounts due from them to the party of the first part.

"REPORTS.

"FOURTH—Parties of the second part shall for-

ward to party of the first part, weekly, Daily Reports of all policies issued by them or their agents, and copies of all endorsements.

"They will also forward, not later than the tenth of each month, Monthly Reports or Statements of Account, which shall include all premiums written by them or their sub-agents during the preceding calendar month, except that the business for December in each year shall be closed on or before the 20th of that month and the Monthly Report for that month shall be forwarded not later than the 25th of December.

"PAYMENT OF BALANCES.

"FIFTH—Parties of the second part agree to pay balances due party of the first part as follows: The balance for January during the month of April; the balance for February during the month of May, and so on throughout the year. For this purpose party of the first part will treat vouchers for losses and adjustment expenses paid as a satisfactory remittance on account; and it is agreed that said remittances or vouchers will be forwarded so as to reach party of the first part before the close of the month in which they are due.

"Parties of the second part guarantee the payment to the party of the first part of all premiums on policies issued by them or their agents, and shall in no case be entitled to credit by reason of their failure to collect said premiums from their agents or from the assured, except that policies returned for non-payment of premiums within sixty

days of issue will be credited for the full premium thereon, less the commission allowed.

"RE-INSURANCE,

"SIXTH—Said parties of the second part are authorized to accept lines in excess of the amounts provided for in the line sheets of party of the first part, provided such excess [127] lines are immediately reinsured by parties of the second part in Companies acceptable to party of the first part. If such reinsurance is effected in the First Bulgarian Insurance Company in accordance with the re-insurance treaty existing between said party of the first part and said First Bulgarian Insurance Company, said parties of the second part authorize party of the first part to charge back such a percentage of the premiums ceded to the First Bulgarian Insurance Company as will make net commission cost of said reinsured lines to the party of the first part not to exceed 22½%. The said charge will be made monthly by party of the first part and reported to parties of the second part.

"COMPENSATION.

"SEVENTH—Party of the first part will allow parties of the second part, as compensation for their services, an overriding commission of 15% upon such premiums (less return and reinsurance premiums) as parties of the second part allow not to exceed 15% upon to sub-agents or brokers; and 10% upon such premiums (less return and reinsurance premiums) as under the rules of the vari-

ous rating associations parties of the second part pay more than 15% upon.

"Party of the first part shall pay through parties of the second part all brokerages and commissions, Government taxes, licenses and fees, assessments for the maintenance of rating associations and fire patrols, the actual cost of the adjustment of losses, bills for which shall accompany proofs, and shall furnish policies and Daily Report blanks and such other supplies as are usual and necessary.

"Parties of the second part shall pay all other expenses incident to the business not herein specifically assumed by party of the first part.

"CONTINGENT COMMISSION.

"EIGHTH—In addition to the compensation heretofore specified party of the first part will allow parties of the second part annually, in January, a contingent commission upon the profits of the party of the first part in said General Agency to be computed as follows:

"1. Of the premiums, less return premiums and reinsurance (both agency and home office) written during the year for party of the first part by parties of the second part, one-third shall be considered unearned and two-thirds shall be considered earned. To the earned premiums shall be added the [128] amount deducted from the previous year's computation of contingent as unearned. From this sum shall be deducted all brokerages, commissions, taxes, assessments and expenses of every name and nature borne by party

of the first part and all losses incurred (less salvage and reinsurance recovered) during the year. The balance shall be called the net profits.

"2. A sum equal to 15% of the net profits as shown in the foregoing computation shall be allowed parties of the second part by party of the first part as contingent commission.

"3. If the General Agency shall be closed at any time the settlement of the contingent commission shall be deferred until January first next following the date of termination. At that time no sum shall be deducted as unearned and no subsequent or further claim shall be made by parties of the second part on account of contingent commission.

"RETURN COMMISSIONS.

"NINTH—In case of a general reduction of rates to such a figure that party of the first part is unwilling to accept the business offered and its policies are surrendered by the assured, it is agreed that the earned premiums will be computed at short rates, that parties of the second part will as far as possible require agents and brokers to charge back return premiums to be charged to it on the same basis as is allowed to agents and brokers by parties of the second part. Parties of the second part will not be required to refund their over-riding commission.

"TENTH—This contract may be terminated at any time by either party giving the other sixty days' notice in writing, at the expiration of which time this contract shall cease and determine. It is,

however, understood and agreed that parties of the second part shall, upon request of this Company, immediately discontinue writing any policies for this Company or committing it on any risks either directly or indirectly.

"IN WITNESS WHEREOF the party of the first part has caused its corporate seal to be hereto affixed and these presents to be signed by its President, and the parties of the second part have hereunto set their hands and seals the day and year first above written.

"AGRICULTURAL INSURANCE CO.
"By W. H. STEVENS, Pdt.
"EDWARD BROWN & SONS.

[129] AGRICULTURAL INSURANCE COMPANY.

"Watertown, N. Y.
"July
Twentieth,
1923.

"Mr. Arthur M. Brown,
c/o Edward Brown & Sons,
"San Francisco, Calif.

"Dear Mr. Brown:—

"We have your letter of July 9th advising that you have taken your son, Arthur M. Brown, Jr., into partnership and ask that we authorize you to add his name to the endorsement dated August 1st, 1922, to the present agency contract. We think that the date should be referred to as August 30th, 1922. This is consented to by us and you may

use this letter in conjunction with your own as constituting the change.

"We have no doubt that the entry of your son officially into the business marks in your own mind a milestone that will always be looked upon with gratification. We wish the new organization an abundant success.

"Yours very truly,
"P. H. WILLMOTT,
"Secretary."

"PHW/P."

[130] "WHEREAS by mutual consent, and the death of Herbert H. Brown, the contract between the AGRICULTURAL INSURANCE COMPANY and ARTHUR M. BROWN and HERBERT H. BROWN, dated January 1, 1911, together with the various amendments thereto relating, *inter alia,* to additional territory and classes of business, Re-Insurance, etc., is hereby amended as follows, except so far as it applies to matters now pending under same.

"NOW, THEREFORE the AGRICULTURAL INSURANCE COMPANY hereby appoints said ARTHUR M. BROWN, trading as EDWARD BROWN & SONS, General Agent for the territory and classes therein mentioned, said appointment being subject to all the conditions named in said contract of January 1, 1911, and its amendments, and said Arthur M. Brown hereby accepts said appointment.

"Executed at Watertown, New York, this Thir-

(Testimony of Arthur M. Brown.)

tieth day of August, A. D., Nineteen hundred and twenty-two.

"AGRICULTURAL INSURANCE COMPANY,

"By W. H. STEVENS,

"President.

"ARTHUR M. BROWN.

"and at San Francisco, Calif., this 5th day of September, A. D. 1922."

[131] WITNESS.—(Continuing.)

This paper writing, dated October 11th, 1918, between Hudson Insurance Company and Arthur M. Brown and Herbert H. Brown is the general agency agreement between the Hudson Insurance Company and Edward Brown & Sons. The attached endorsements are of the same nature as the endorsements I have previously referred to.

Thereupon the documents referred to were offered and received in evidence as Petitioner's Exhibit No. 7, and were so marked. Subsequently, copies of said original documents were substituted for said originals and marked Exhibit 7, and said originals and copies were and are as follows:

PETITIONER'S EXHIBIT No. 7.

[132] "THIS AGREEMENT made and entered into this 11th day of October, 1918, by and between the HUDSON INSURANCE COMPANY, of NEW YORK, party of the first part, and ARTHUR M. BROWN and HERBERT H. BROWN, as copartners constituting the firm of

EDWARD BROWN & SONS, of SAN FRANCISCO, CALIFORNIA, parties of the second part, WITNESSETH:—

"ARTICLE I.

"In consideration of the fulfillment of the mutual agreements herein made, the party of the first part appoints the party of the second part its GENERAL AGENTS for the States of Arizona, California, Coloraro, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington and Wyoming, as well as for the territories of Alaska and Hawaii and the Province of British Columbia, with full power and authority to appoint and remove Agents in said States to accept service of process for the HUDSON INSURANCE COMPANY, to adjust losses under the policies of said Company, to receive and acknowledge service of Proof of Loss, to issue, countersign and cancel its policies and to receive and receipt for premiums thereon and generally to conduct the business of said Company in the territory above mentioned in accordance with such instructions and directions as they may from time to time receive from the said Company.

"ARTICLE II.

"The Local Agents in the said territory shall report their business to the said General Agents, and the party of the second part hereby agrees to forward promptly to the Home Office of the party of the first part, bordereaux of risks written and of endorsements made under policies issued by agents in said territory, also to promptly report in the

same manner all policies written in the office of the party of the second part and endorsements made on such policies by them; also to report promptly to the party of the first part all appointments, removals and changes of agents, and to furnish other information which said party of the first part may desire in connection with said business. The party of the first part reserves the right to reject and cancel any business sent in that is not entirely satisfactory to it.

"ARTICLE III.

"The said party of the second part shall forward not later than the Fifteenth (15th) of each month a monthly report or statement of account for the preceding month, of all [133] business done for the party of the first part by said party of the second part, as well as through all the authorized agents in the territory named, and shall forward to said party of the first part the balances shown by such statements within eighty-five (85) days after the close of the month for which said account was made up, and the said party of the second part does hereby agree to assume and does assume the responsibility to said party of the first part for the premiums written by them or by the agents in said territory. It is agreed that policies cancelled for non-payment of premiums are to be returned to the party of the first part as uncollectible within Ninety (90) days after the month in which they are issued, otherwise the said party of the first part is to be credited with the earned premium for the full period from the date of issue to the date of

cancellation. It is understood that on all cancellations and reinsurance effected on business written under this Agreement there shall be returned to the said Company the same percentage of commission, inclusive of overriding commission, as was allowed on the original transaction.

"ARTICLE IV.

"The said party of the second part shall forward to said party of the first part a satisfactory Bond in the sum of Ten Thousand ($10,000) Dollars conditioned upon the satisfactory discharge of their indebtedness to the said party of the first part and the faithful performance of their obligations under this Contract.

"ARTICLE V.

"The party of the second part shall forward to the party of the first part weekly reports of all losses, and the party of the second part is hereby authorized to provide for the adjustment of the losses, the losses when adjusted to be paid in the manner directed by the party of the first part. It is, however, understood and agreed that in event of differences arising in the adjustment of any loss, or in case of threatened litigation arising in connection with any claim, the party of the second part will immediately and fully communicate all the facts to the party of the first part, so that the party of the first part may have full information and advise the party of the second part of its wishes in the matter.

"ARTICLE VI.

"Said party of the first part agrees to pay the

party of the second part an overriding commission of Fifteen (15%) per cent on the net premiums written in cases where the local agency commission under the rules of the Pacific Board [134] of Fire Underwriters is Fifteen (15%) per cent., and an overriding commission of Twelve and one-half (12½) per cent. on all other business. By net premiums is meant gross premiums less return premiums and reinsurance placed through the said General Agents.

"The party of the first part hereby agrees to pay the party of the second part the amount of contingent commission actually allowed the local agents representing the party of the first part in the territory of Hawaii and the Province of British Columbia.

"The said overriding commission of Fifteen (15%) per cent. and twelve and one-half (12½) per cent., respectively, shall be in full for all costs of the business of the party of the first part, with the exception of commissions paid to local agents, taxes, fees, licenses (both State and Municipal) loss adjustment expenses paid by the party of the second part, legal expenses, advertising required by Law, Local Board and Fire Patrol assessments; and the party of the first part further agrees to furnish for the use of the agents in said territory policy blanks, daily report and endorsement blanks, as well as other supplies which are necessary for the reporting of the business to the party of the first part, together with such signs, blotters, and

other advertising matter as said party of the first part may see fit to furnish.

"ARTICLE VII.

"IT IS UNDERSTOOD AND AGREED that on the business ceded to the Treaty Companies the party of the second part shall be allowed an overriding commission of seven and one-half (7½) per cent. on the Fifteen per cent. (15%) business, and Five per cent (5%) on all other business, or, in other words, 7½% less overriding commission than allowed on the business actually retained for own account by party of the first part.

"ARTICLE VIII.

"IT IS UNDERSTOOD AND AGREED that the party of the second part may issue policies against the hazard of explosion and may also write hail insurance, the commission on said business to be (inclusive of overriding commission) Twenty (20%) per cent. and Thirty-two and one-half (32½%) per cent. respectively, with 7½% deduction for portions reinsured, as above set forth.

"ARTICLE IX.

"THE PARTY OF THE FIRST PART FURTHER AGREES to pay the party of the second part a further compensation of fifteen [135] per cent. (15%) contingent commission on the net profits earned on the business transacted for the party of the first part, the net profits to be determined by calculations as follows:

"INCOME

"(1) Gross premiums written during the year, with deduction for return premiums and reinsurance premiums.

"(2) Premium Reserve from Statement of the previous year.

"(3) Losses unpaid from the statement of the previous year, with deductions for reinsurance proportions.

"OUTGO

"(1) Commissions and all expenses of every nature allowed under this Agreement, with deduction of an amount equal to 25% on the net business ceded to the Treaty Companies.

"(2) All losses paid during the year with deduction for reinsurance proportions.

"(3) All unpaid losses at the end of the fiscal year, with deduction for reinsurance proportions.

"(4) Forty per cent (40%) Premium Reserve on the net premiums written during the year, with deduction for return premiums and reinsurance premiums, as well as Hail premiums.

"IT IS UNDERSTOOD AND AGREED that the first calculation of profit under this Contract shall be made up as of December 31, 1919, and forwarded to the party of the second part as soon as possible after the date referred to, and annually thereafter, on the business of each single fiscal year, as long as this Agreement shall remain in

force. PROVIDED, HOWEVER, that [136] should this Contract be terminated before the close of any fiscal year, the contingent commission shall nevertheless be computed for the whole fiscal year as above set forth.

"ARTICLE X.

"In case of a general reduction in rates, to such a figure that the party of the first part is unwilling to accept the business offered, and its policies are surrendered by the assured, it is UNDERSTOOD AND AGREED that the earned premiums will be computed on the short rate basis, and that the party of the second part will endeavor as far as possible to obtain from the Agents and Brokers the return commissions due the party of the first part, but failing so to do the party of the first part waives the right of charging the party of the second part with such uncollectible amounts, and it is FURTHER UNDERSTOOD AND AGREED that the parties of the second part will not be required to refund their overriding commission on policies thus cancelled.

"ARTICLE XI.

"This Contract may be terminated at any time by either party giving Ninety (90) days notice to the other, at the expiration of which time this Contract shall cease and terminate, and in case of their so doing neither shall have any claim on the other for loss of prospective profit or damage to business arising therefrom, and the duties of each party to the other shall continue in full force and effect

until the termination of said Ninety (90) days, unless otherwise mutually agreed.

"IN WITNESS WHEREOF, the said HUDSON INSURANCE COMPANY of NEW YORK, and EDWARD BROWN & SONS, of SAN FRANCISCO, CALIFORIA, have affixed their signatures to this AGREEMENT the day and year first above written.

"HUDSON INSURANCE COMPANY,

"(Corporate Seal)

"J. W. WENNSTROM,

"Vice-President.

"EDWARD BROWN & SONS,

"HERBERT H. BROWN.

"C. N. MORGAN,

"Secretary.

"FRANK G. CLARK.

[137] "ADDENDUM to AGREEMENT made and entered into October 11th, 1918, by and between the Hudson Insurance Company, of New York, party of the first part, and, in accordance with duly executed Addendum, Arthur M. Brown and Arthur M. Brown, Jr., of San Francisco, Calif., as copartners constituting the firm of Edward Brown & Sons, parties of the second part.

"WITNESSETH: IT IS HEREBY MUTUALLY UNDERSTOOD AND AGREED that from January 1st, 1926, the present wording of Article VII is hereby deleted and shall read as follows:

"ARTICLE VII.

"'It is understood and agreed that on the busi-

ness ceded to the Treaty Companies the party of the second part shall be allowed an overriding commission of Nine and one-half (9½) per cent on the fifteen (15) per cent business and seven (7) per cent on all other business. Or, in other words, five and one-half (5½) per cent less overriding commission than allowed on the business actually retained for own account by the party of the first part.'

"It is further understood and agreed that from the date mentioned, in Article IX, Outgo (1) Thirty (30) per cent is substituted for twenty-five (25) per cent.

"Made in duplicate, duly signed and executed in New York, this 8th day of April, 1926.

"HUDSON INSURANCE COMPANY,

"(Corporate Seal)

"By J. M. WENNSTROM,

"President.

"and in San Francisco, on the 26th day of April, 1926.

"EDWARD BROWN & SONS, General Agents.

"By ARTHUR M. BROWN, Jr.

[138] "ADDENDUM TO AGREEMENT

"made and entered into October 11th, 1918, by and between The Hudson Insurance Company, of New York, party of the first part, and Arthur M. Brown and Herbert H. Brown, of San Francisco, California, constituting the firm of EDWARD BROWN & SONS, party of the second part,

"WITNESSETH:

"IT IS HEREBY UNDERSTOOD AND

AGREED that the firm of Edward Brown & Sons, party of the second part, is now constituted of Arthur M. Brown and Arthur M. Brown, Jr., as co-partners.

"Made in duplicate and duly signed and executed in New York, July 27th, 1923.

"HUDSON INSURANCE CO.

"(Corporate Seal)

"J. M. WENNSTROM,

"President.

"and in San Francisco, California, August ——, 1923.

"EDWARD BROWN & SONS,

_____.

_____.

[139] (LETTER-HEAD OF HUDSON INSURANCE COMPANY OF NEW YORK.)

"AMENDMENT TO AGREEMENT DATED OCTOBER 11th, 1918, BETWEEN HUDSON INSURANCE COMPANY OF NEW YORK AND EDWARD BROWN & SONS, GENERAL AGENTS, OF SAN FRANCISCO, CAL.

"This contract is hereby changed to read:

"HUDSON INSURANCE COMPANY OF NEW YORK AND ARTHUR M. BROWN, DOING BUSINESS AS EDWARD BROWN & SONS.

_____,

"Vice President.

"August 1st, 1922."

(Testimony of Arthur M. Brown.)

[140] WITNESS.—(Continuing.) During the years in question, from 1918 on, we were also Pacific Coast general agents for the United States Merchants and Shippers Insurance Company, sometimes known as United States Lloyds, appointed under a written contract. I have had search made for that contract but have been unable to find it. It was kept in our vault at our office at #200 Bush Street, and I caused search to be made in that vault, but was unable to find it. It was in all respects like the Agricultural Insurance Company contract. I drafted it by copying the Agricultural contract.

During this period Edward Brown & Sons also represented the Hamilton Fire Insurance Company and was Pacific Coast general agent for Globe & Rutgers Fire Insurance Company of New York City, but we did not have a written contract with either. "Globe Underwriters" is not an independent corporation, but simply a title under which Globe & Rutgers Fire Insurance Company is permitted to operate. In the conduct of the business for the Hamilton Fire Insurance Company and the Globe & Rutgers Fire Insurance Company for 1917 and on through 1926 the business was not conducted in any different way, nor did we do any different things for those companies than for the companies as to which written contracts have been introduced in evidence. The business as to all of [141] the companies was conducted exactly the same. There were differences in rates of commission. The rate

(Testimony of Arthur M. Brown.)

of commission for the Hamilton was 11% overriding commission paid on the basis of net premiums. Net premiums are the gross premiums written, less cancellations and reinsurance as effected. For the Globe & Rutgers we received 11% overriding commission on certain of the business, known as our direct writings, and 7% overriding commission on what was known as the surplus amount, and 2½% on other business. These commissions were on policies which our office wrote and which were written through our territory. Our commissions for the Globe & Rutgers were figured on a net premium basis. That was arrived at in exactly the same way as outlined in the contracts here. It was agreed upon in conversations between ourselves and officers of the company. All compensations were upon net premium writings. The substance of the conversations with respect to our duties were that we were to appoint and cancel agencies, supervise underwriting, attend to all endorsements and cancellations as they came in, collect and remit to the companies premiums due net to them, adjust and pay all losses, represent the company, and attend to any legal matters that might come up in connection with the business and to attend to all the affairs of the company within the territory in which we operate. For the Globe & Rutgers Fire Insurance Company we operate the entire Pacific Coast, ten states, the territories of Alaska and Hawaii and the Philippine Islands. For

(Testimony of Arthur M. Brown.)

the Hamilton we operate the States of California, Oregon and Washington.

[142] In nearly every case a policy is written by the agent. We have no direct dealings with the assured.

Thereupon counsel for petitioner read into the record Section 5009 of the Compiled Statutes of the State of Idaho as follows:

> "It shall be unlawful for any foreign insurance company doing business in this State to make, write, place or cause to be made, written or placed in this State, any policy, bond, duplicate policy, or contract of insurance of any kind or character or of any general or floating policy upon persons or property resident, situated or located in this State, unless done through an agent who is a resident of this State and licensed to transact insurance business herein. A resident agent shall countersign all policies issued (except policies of life insurance), and shall receive the full commission when the premium is paid, to the end that the State may receive the tax required by law to be paid on the premiums collected for insurance on all persons and property resident or located within this State: Provided this section shall not apply to life insurance companies."

WITNESS.—(Continuing.) No different procedure was followed with respect to the commission of the local agents in any territory for any of our companies than was followed with respect to the com-

(Testimony of Arthur M. Brown.)

mission of the local agent in the State of Idaho—they were all treated the same in the territories.

When we were appointed general agent for a company we performed service for the company before the actual writing of any insurance. Agents had to be appointed and all the State papers had to be attended to, to obtain the company's entry into the state. We handled the details of the qualification of a company [143] to do business in the state as a foreign corporation, and the details with respect to the offices of the insurance commissions of the various states. We have to see that the company is put into condition to do business in a particular state. With the exception of policy blanks and reports of the company we furnish all of the stationery for the writing of insurance. The agents are, in a great majority of cases, appointed by special agents employed by us, fieldmen, we call them. This is the certificate we use for agents (producing document).

Thereupon the document produced was offered and received in evidence as Petitioner's Exhibit No. 8, was so marked, and was and is as follows:

PETITIONER'S EXHIBIT No. 8.

"This is an Agency of

"EDWARD BROWN & SONS

"Pioneers of Protection

"Since 1875

"CERTIFICATE OF AUTHORITY.

"BE IT KNOWN, that ——— of ———, in the county of ——— in the State of ———,

(Testimony of Arthur M. Brown.)

ha—— been appointed by these presents duly constituted agent of the following, to wit: ——— with full power to receive proposals for insurance against loss or damage by fire, in ——— and vicinity, to ——— deliver policies to applicants, and collect and forward the premiums on same, subject to the rules and instructions which may, from time to time, be given by the General Agents of the said Company.

[144] "IN WITNESS WHEREOF, the General Agents of the ——— Insurance Company have signed these presents in the City of San Francisco, California, this —— day of ———, 19——.

"———————————

"Pacific Coast General Agents."

WITNESS.—(Continuing.) Edward Brown & Sons had full authority to select and employ agents and to revoke their licenses when deemed necessary, and during this whole period that practice was actually followed. The agent or broker is the one who actually goes out, gets the assured, and sells him the contract of insurance. We have nothing to do with that. We prepare the necessary stationery forms and supply these to the local agents, and we supply them with a great deal of servicing and information service. We employ fieldmen whose business it is not only to appoint agents but to assist them in obtaining business, at their request to survey and assist them in rating risks, and to do everything they can to push the agent's business. That service has no relation to the writing of any par-

(Testimony of Arthur M. Brown.)

ticular policy, and such service has, in fact, been given, when the policy was written in some company not represented by us.

As to the actual writing of the policy there are two classes of agents; recording agents and nonrecording agents. The former are the larger ones who have a thorough knowledge of the [145] business and are permitted to sign policies. Those who are doing a small business and are not equipped send their applications to our office and the policies are written there. In the greater number of instances these policies are sent back to the agent to be countersigned. There is no difference in the rate of commission paid to recording and nonrecording local agents, nor is there any difference in the rate of commission we receive on policies written by recording or nonrecording agents.

We must perform service in connection with determining what form of policy shall be used on a particular risk. We supply the recording agents with a full set of forms. The nonrecording agents' applications are certified in our office, and the form there determined. Riders are used in writing insurance. We supervise the supplying of riders and when they are used we must scrutinize them as carefully as the original policy. The form of riders is determined by the Board of Underwriters of the Pacific. We perform a service in connection with that organization. I am chairman of what is known as the Standard Forms Bureau, which is a subsidiary body of the Underwriters of the Pacific,

(Testimony of Arthur M. Brown.)

and for many years have been on many of the committees.

The Board of Underwriters of the Pacific is an organization made up of the great majority of the standard insurance companies, for the survey and betterment of business and the making of [146] rates. We act on the Board of Underwriters for the companies for whom we are general agent.

When an agent sends us a policy which has been written we have to inspect the risk, and it is entirely up to us whether that risk shall be accepted or rejected. That matter is not referred to the home office, and we have rejected many risks submitted by local agents.

After a policy has been written the premium is presumed to be paid within sixty days. We must see that it is collected, and we compute it. The rate of premium on the policy is checked by us. A daily report is submitted to the Board of Underwriters, and it is again checked there. We compute the local agent's commission, and likewise our own commission. We make up such statements as are rendered between ourselves and the local agents. It is our duty to see that the premiums are actually collected. We remit to our companies by monthly balances, and unless we collect the premium we lose it.

After a risk is accepted the matter of reinsurance is entirely in our hands. By reinsurance we mean this: If a line is written in excess of what the company or general agent believes advisable, on a cer-

(Testimony of Arthur M. Brown.)

tain risk, we must either reduce the amount of the policy or must reinsure the excess in other companies. In 99% of the cases this reinsurance is effective. A [147] "treaty company" is a reinsurance company, which in most instances obtains the first line of reinsurance above the net line of the parent company. That is by arrangement between the parent company and the treaty, and we are advised of the arrangement. There is a very large amount of reinsurance that is not controlled by treaty arrangement. Where there is a treaty arrangement we must exercise judgment on behalf of our company as to the amount of reinsurance with the treaty. Where there is no treaty we determine the amount of reinsurance and with whom we are to reinsure. We control the reinsurance entirely. We do not get any further compensation when we reinsure a line. Sometimes we reinsure within our own organization, that is, reinsure one of our companies in another of our companies. Some reinsurance is written outside of our office by companies not represented by us. We arrange for the payment of premium when reinsurance is obtained, and should it be cancelled we are charged with the function of seeing that repayment is made. The whole matter is entirely in our charge. We are paid no further compensation, but all the services included within the original rates I mentioned.

After a policy has been written by a local agent we very often change the reinsurance without changing the primary policy itself. We may give a com-

(Testimony of Arthur M. Brown.)

pany a portion of the reinsurance and it may cancel it and we have to replace it. Very often [148] after a policy is written which did not require reinsurance, we get rid of the risk or protect it by reinsurance, without cancelling the policy. If our company were to get a full net line and later the agent would give the company another line on the same risk we would have to reinsure it. We determine that within a certain limitation only so much by way of risk should be assumed, as in a given building. If the first risk in that building were a millinery store, and we were later offered a hardware store, we would consider that a better risk, and if the limit had already been reached with the millinery store we would be able to take the hardware store by reinsuring the millinery store outside our organization if we could. That would be an occasion of reinsurance which had nothing to do with the writing of the original policy, and there is no extra compensation received by us for that.

We report our business to the home office once a month. A bordereau is a *résumé* of the month's business. This is a bordereau of return premiums, cancellations and endorsements for the Globe & Rutgers Fire Insurance Company for June, 1927. It is one of the forms of reports we get up for our companies and shows in detail, by the general agency, and by the state, the gross and net writings of the company, cancellations, return premiums and reinsurance. It shows by policy number and company [149] every transaction had. For each nature of transaction, monthly, for the year.

(Testimony of Arthur M. Brown.)

Mr. DUNNE.—If your Honor please, there is, of course, a very well-recognized rule of evidence that when accounts are long and complicated and unwieldly, it is competent for the parties to introduce in evidence summaries. We offer at this time to the Government to permit them to inspect any of the records that we have here, or in our office in San Francisco, and shall show that these records have already been investigated, and I shall ask the record to show one of these bordereaus for one company.

WITNESS.—(Continuing.) This is for one company for the months of April, May and June, 1927, showing the full detail of the transactions of the company by state, agency and policy number—a complete record for every dollar written and every return premium, showing reinsurance and cancellations, as well as new business.

Mr. DUNNE.—I will ask the record to show that this one bordereau in those three months for one company, for this year, is a book about 2½ feet long, I should say about 14 inches wide and about 6 inches thick, and weighing about 25 or 30 pounds. I will have to prove the figures eventually as to the earned commissions. They will not appear in these books, but these books, in the first place, show the records of the services performed, [150] and, in the second place the figures will come in and I want this matter in the record to show that these records are so voluminous that we could not have them here.

(Testimony of Arthur M. Brown.)

WITNESS.—(Continuing.) We make up yearly reports for our companies.

Edward Brown & Sons are the only general agents in the United States who are permitted to give a form of certificate of authority which is in their own name, such as that introduced in evidence here (Petitioner's Exhibit 8). Everywhere else the certificate is required to be in the name of the company.

In the reports to the companies we show business written, reinsurance, cancellations, return premiums, reinsurance losses, and premium income. We have settlement sheets and show expense of advertising, supplies and litigation. We maintain a statistical department for giving this information. We receive no extra compensation for this. When it is necessary to supply local authorities, municipal, state or federal, with reports, we prepare these on behalf of our companies, and we take care of payment of local license fees, taxes and things of that sort. Our remittances and dealings with our companies are strictly on a net basis. They have nothing to do for themselves except that two of our companies do pay state taxes directly.

We handle supplies for ourselves and our local agents, and for this purpose maintain a printing press. That [151] covers all of the necessary forms for writing insurance, except policy blanks and advertising matter.

After a policy has been written it is quite often necessary to change the terms. This is done by en-

(Testimony of Arthur M. Brown.)

dorsement. Thus if insured property is sold the insurance can be transferred by endorsement. No further commission is paid to us for that endorsement. When an endorsement is put on there are three possible results; it may be without change in premium; it may be with decrease in premium, in which event we refund that proportion of our overriding commission, and it may be with increase in premium, in which case we obtain our overriding commission. This last is the only time, after a policy is written, when our commission is changed by the receipt of further commissions, except in the case of industrial accident policies where the premium is determined at a later time, and an additional premium is paid so that the provisional premium will come up to the rate required. We take care of the mechanics of computing the premiums, and that is all gone over again just as I have described in the case of the original writing.

If a policy is cancelled by the assured we pay to the assured the short rate return premium without drawing on our company but out of our own funds. We do not keep any bank accounts for the companies except for one, the Svea. In the event of cancellation of reinsurance we take care of the details of the return commission.

[152] We control the cancellation of policies for the companies. In the event the premium is returned to the assured on a prorated basis we pay it back, drawing our own checks.

While a policy is in force we must perform ser-

(Testimony of Arthur M. Brown.)

vice with respect to the risk. We have to very carefully watch all classes of risks in all localities to determine whether or not the business continues to be profitable. If a town should go down hill it is our duty to scrutinize the business, and if the conditions are not good we cancel of our own volition. The companies have no control over that; we exercise our own judgment entirely. In one instance after the business had been written and the premium paid, on hail insurance, there was a bad drought and we cancelled and returned the full amount of premiums, rather than subject the people to something they knew they could not recover. Part of the premium had already been earned. We did not consult our companies.

If there is a loss under a policy we adjust it, and after proofs of loss are received, make necessary payments. At times we make thorough investigations requiring months, and we determine whether or not a particular loss shall be paid. We do not refer these matters to the companies, and in the event of threatened litigation we determine whether or not we shall continue to refuse to pay. In the event of litigation we control it, [153] but the companies pay the legal fees and costs of litigation. We receive no compensation for our own services in connection with that litigation. We have nothing to do in relation to our companies other than making net remittances to them, after we have taken care of all new business, reinsurance, cancellations, return premiums, collection of returned reinsurance, and

(Testimony of Arthur M. Brown.)

the payment of costs, losses and expenses. We never consult with them on any details—only on general matters of policy.

We have invested about $250,000 in the business of Edward Brown & Sons. Occasions have arisen when we have remitted to our companies such amounts that future contingencies arose which did not leave on hand money to their credit sufficient to cover it, and we had to go out and borrow money to take care of expenses and payments to our companies, and paid interest on it. We are not reimbursed for that by our companies, but it is included in the original commission paid.

We exercise constant supervision over risks, so we can determine whether or not risks shall be accepted. We send our engineers and fieldmen around to various localities to inspect almost every mercantile and manufacturing risk we have. We watch very carefully the markets and general conditions all over our territory. In case anything seems extraordinarily bad we discharge the man there and investigate. We investigate and keep track of new buildings and changed conditions. We keep detailed maps of the whole [154] territory over which we have jurisdiction for our companies. We belong to credit rating bureaus, and check up against the risk every moral hazard, and financial standing. Rates are determined by the Board of Underwriters, and we represent our companies on that Board. Over the period we are discussing we have a peak

(Testimony of Arthur M. Brown.)

in the writing of fire insurance which comes in the summer months.

Special pools are pools of companies for the purpose of taking care of extraordinary or unusual hazards. The logging pool interests of Oregon and Washington take care of the immense amounts required in covering the logging equipment in the woods and the timber as it is cut, which is too large for one company. We determine whether our companies will go into pools, without reference back to the home office.

In fact, we do not refer anything back to the home companies.

Our relation as general agent for the United States Merchants & Shippers terminated three or four years ago. After that policies written through our office were cancelled, and in the event of such cancellations we return the unearned portion of our commissions—that portion of the commissions which is related to the unearned portion of the premium.

Cross-examination by Mr. MEACHAM.

My son is thirty, I think. He first came into the office as a clerk for several years, prior to 1924, on a [155] salary basis, not a partner.

When we cancelled the hail insurance in Montana that I spoke of, and returned the premiums, there was no obligation to do so. It was a form of advertising of our business, if you like to put it that way.

Thereupon counsel for respondent, pursuant to subpoena and pursuant to request of counsel for

petitioner, produced the revenue agent's report as to petitioner's income for the year 1923, which was dated May 6th, 1927, and it was stipulated that said report was made by the agent of the Internal Revenue Department, who was employed by the Government for the purpose of examining the books of the taxpayer and making the report on that subject back to the Commissioner of Internal Revenue, and that the report produced was such report. Counsel for petitioner then offered in evidence the following from page 4 of said report:

> "The accounts in connection with the general insurance agency of taxpayer may be said to be kept on an accrual basis."

Petitioner then offered, not as binding on him, but simply as the revenue agent's report itself, and as showing what he handed to the Commissioner, and upon what the Commissioner acted, the whole report. Respondent objected to the report on the ground that it was incompetent, irrelevant and immaterial, and had no bearing on the issues of the case.

[156] EXCEPTION No. 1.

Thereupon said objection was sustained upon the ground of incompetency. To such ruling petitioner then and there duly excepted and now excepts and assigns the same as error.

EXCEPTION No. 2.

Thereupon counsel for respondent moved to strike out the portion of the report read into the record. Counsel for petitioner objected to said motion upon the ground that the objection should have preceded

the offer. Thereupon said motion was granted, and the said matter ordered stricken, to which said ruling petitioner then and there duly excepted and now excepts and assigns the same as error.

Said report was subsequently, and as hereinafter appears, marked Petitioner's Exhibit No. 17 for identification.

Thereupon counsel for respondent, pursuant to subpoena, and pursuant to demand, produced the individual income tax return for the calendar year, 1923, of petitioner, Arthur M. Brown, and thereupon petitioner offered the same in evidence, and the same was received in evidence, as Petitioner's Exhibit No. 9, and was so marked. Said exhibit not being in form susceptible of reproduction here or in a printed transcript, it is respectfully prayed that the original be attached hereto and to the transcript on appeal herein, and be forwarded to the [157] Circuit Court of Appeals for the Ninth Circuit with the transcript of record herein.

Thereupon, pursuant to similar subpoena and request, counsel for respondent produced the original individual income tax return of petitioner for the year, 1925, and thereupon petitioner offered the same in evidence, and the same was so received, as Petitioner's Exhibit No. 10, and was so marked. For the same reasons as in the case of Exhibit No. 9, it is prayed that said exhibit be made a part of the transcript on appeal herein, as in the case of Petitioner's Exhibit No. 9.

Thereupon, counsel for petitioner being unable to produce the original partnership return for the year,

1925, petitioner, without objection, offered, and there was received in evidence, as Petitioner's Exhibit No. 11, and so marked, a copy thereof, and it was thereupon stipulated and ordered that counsel for respondent might substitute therefor a photostatic copy of the original. For the same reasons as in the case of Exhibit No. 9, it is prayed that said exhibit (or a photostatic copy of the original in the event such was substituted for the original exhibit) be made a part of the transcript on appeal herein, as in the case of Petitioner's Exhibit No. 9.

Thereupon, pursuant to similar request and subpoena, as in the case of Petitioner's Exhibit No. 9, counsel for respondent produced the original income tax return of petitioner [158] for the, year 1926, and thereupon petitioner offered the same in evidence, and the same was so received, as Petitioner's Exhibit No. 12, and was so marked. For the same reasons as in the case of Exhibit No. 9, it is prayed that said exhibit be made a part of the transcript on appeal herein, as in the case of Petitioner's Exhibit No. 9.

Thereupon, counsel for petitioner being unable to produce the original partnership return for the year, 1926, petitioner, without objection, offered, and there was received in evidence, as Petitioner's Exhibit No. 13, and so marked, a copy thereof, and it was thereupon stipulated and ordered that counsel for respondent might substitute therefor a photostatic copy of the original. For the same reasons as in the case of Exhibit No. 9, it is prayed that said exhibit (or a photostatic copy of the original in the event

such was substituted for the original exhibit) be made a part of the transcript on appeal herein, as in the case of Petitioner's Exhibit No. 9.

Thereupon there was identified, offered and received in evidence as Petitioner's Exhibit No. 14, and so marked, a copy of respondent's so-called sixty-day deficiency letter to petitioner with respect to petitioner's tax for the year, 1923, which said letter was and is as follows:

PETITIONER'S EXHIBIT No. 14.

"TREASURY DEPARTMENT.
Washington.

"IT:FAR:B-2.
"LCT-60D.

"Dec 22, 1927.

[159] "Mr. Arthur M. Brown,
"200 Bush Street,
"San Francisco, California.

"Sir:

"The determination of your income tax liability for the year 1923, discloses a deficiency of $17,923.03, as shown by the attached statement.

"In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United State Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

"Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

"If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:FAR:B-2-LCT-60D.

"In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

"Respectfully,

"D. H. BLAIR,

"Commissioner.

"By _____,

"Deputy Commissioner.

"Inclosures:

"Statement:

"Form A.

"Form 882 SDG-2.

[160] "STATEMENT.

"IT:FAR:B-2.
"LCT-60D.

"Dec. 22, 1927.

"In re: Mr. Arthur M. Brown,
"200 Bush Street,
"San Francisco, California.

"Year.	Deficiency in Tax.
"1923.	17,923.03.

"The report of the Internal Revenue Agent in charge at San Francisco, California, transmitted to this office under date of July 22, 1927, has been reviewed with the following exception:

"The deduction of $3,185.15 for Christmas Gifts to employees has been allowed. This deduction was an ordinary and necessary business expense of the concern when it was made and it was recommended by the Internal Revenue Agent in Charge that the amount be allowed.

"The revenue agent has been sustained in regard to the disallowance of the deduction of $52,971.96, representing a reserve for return commissions. Insurance companies are entitled under the Law to set up such reserves, and you contend that being in the insurance business you would be entitled to the same method of computing income. In this connection, you are advised that the provisions of the Law governing insurance companies for the purpose of setting up reserves is statutory. Your business is

not an insurance company inasmuch as you are acting as an agent in writing insurance policies for which you receive a commission. It, therefore, cannot be held that you are entitled to the same provisions as an insurance company.

"It has been held by this office that the deduction of $3,000.00 paid to Edith H. Holton, is a capital expenditure and is not deductible from income. It has also been held by this office that the deduction for a payment to the Industrial Association of San Francisco, is not allowable.

[161] "It is noted that all other adjustments as made by the Revenue Agent have been conceded by you.

"Net income originally reported			$35,563.20
"Salaries reported		$18,000.00	
"As adjusted		21,600.00	
"Income from business reported	$15,590.75		
"As adjusted	73,668.11		58,077.36
"Other deductions as claimed	$2,413.36		
"As adjusted	2,363.36		50.00
"Total income as adjusted			$97,290.56
"Dividends and exemption			6,479.20
"Amount subject to normal tax			$90,811.36

"Total tax		$28,298.57
"25% Reduction, Revenue Act of 1924		7,074.64
"Net tax assessable		$21,223.93
"Tax assessed	$4,401.20	
"25% Reduction, Revenue Act of 1924	1,100.30	3,300.90
"Deficiency		$17,923.03

"Payment of the tax should not be made until bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

"SDG–2."

[162] Thereupon there was identified, offered and received in evidence, as Petitioner's Exhibit No. 15, and so marked, respondent's so-called sixty-day deficiency letter to petitioner, dated February 7th, 1929, and dealing with petitioner's tax for the year 1926, and as Petitioner's Exhibit No. 16, and so marked, respondent's so-called sixty day deficiency letter to petitioner, dated April 28th, 1928, and dealing with petitioner's tax for the year 1925. Said letters (but not the statement attached) are in substantially the form of the letter forming part of Petitioner's Exhibit No. 14, and the same were attached, respectively, to the petitions in the proceedings numbered herein Docket Nos. 43,432 and 39,157, and for that reason the same are not repeated here, but reference to the same, as attached to said petitions, is hereby made, and it is prayed that the original of said exhibits Nos. 15 and 16 be made a part of the transcript on appeal herein and be forwarded to the Circuit Court of Appeals for the Ninth Circuit with the transcript of record herein.

TESTIMONY OF CHARLES W. WHITE, FOR PETITIONER.

CHARLES W. WHITE, called as a witness on behalf of petitioner, being first duly sworn, testified as follows:

Direct Examination by Mr. DUNNE.

I looked at the bordereau shown Mr. Brown, and called to your attention that he was in error as to what it covered —[163] it covers only premiums and return premiums. I am chief accountant for Edward Brown & Sons. That pile of books over there are the records of the business of the firm, and this pile of papers are monthly reports to the insurance companies represented by Edward Brown & Sons of transactions for the month. In making settlement with the companies the settlement is made on the basis of these reports which are summaries by the month of all business written by Edward Brown & Sons. They show new business, cancellations, return premiums, reinsurance, return reinsurance, and the computation of what is due Edward Brown & Sons.

Thereupon, counsel for petitioner stated that the records just identified were those from which the figures to be used were taken, and from which the summaries Mr. Logan would testify to were taken, and that in view of their bulk he preferred not to offer the documents identified; that the only purpose was to substantiate the computations and set-ups made from them by Mr. Logan.

(Testimony of Charles M. White.)

WITNESS.—(Continuing.) The figures for the year, 1923, appear in the Journal, which is among the books here.

EXCEPTION No. 3.

There was then identified and offered in evidence on behalf of petitioner, the reports made by the agent of the Internal Revenue Department with respect to petitioner's income for [164] the years 1925 and 1926, corresponding to Exhibit No. 17 for identification for the year, 1923. The receipt in evidence of said reports was objected to upon the ground that the same were incompetent, and said objection was sustained and the said reports were not receive in evidence, to which ruling petitioner then and there duly excepted, and now excepts, and assigns the same as error, and the said reports were then marked respectively for identification, Petitioner's Exhibits Nos. 18 and 19 for identification. The agent's report for the year, 1923, theretofore referred to as hereinabove appears was then marked Petitioner's Exhibit No. 17 for identification. It is prayed that the original of said reports be attached to the transcript herein and be forwarded to the United States Circuit Court of Appeals for the Ninth Circuit with said transcript, and as a part thereof, and as a part of this statement of evidence.

TESTIMONY OF KENNETH N. LOGAN, FOR PETITIONER.

KENNETH N. LOGAN, called as a witness on behalf of petitioner, being first duly sworn, testified as follows:

Direct Examination by Mr. DUNNE.

I am a certified public accountant, duly licensed to practice as such in the State of California since 1922, and practicing my profession in San Francisco. I had been engaged in the business of accountancy before that—since about 1914—and have had experience in auditing books of insurance companies. At one time I [165] spent approximately eight months for the Board of Fire Underwriters auditing the books of the insurance companies in San Francisco under their jurisdiction. I have been engaged by Mr. Brown as a certified public accountant in connection with the pending matter, and in that connection examined the original books of Edward Brown & Sons and have drawn certain figures from them. This paper headed "Edward Brown & Sons prorate of overriding commissions of Arthur M. Brown's interest" from August 1st, 1922, to December 31st, 1923, is a summary which I prepared and had prepared under my immediate supervision of the amounts of commission which would accrue to Arthur M. Brown on policies written by his companies from

(Testimony of Kenneth N. Logan.)

August, 1922, to December, 1923. Those figures were drawn from the settlement sheets that are prepared monthly for the companies, and I obtained those figures from the books and sheets which Mr. White has just identified.

Thereupon the document referred to was offered and received in evidence as Petitioner's Exhibit No. 20, was so marked and was and is as follows:

[16]

EDWARD BROWN & SONS

Prorate of Overriding Commissions of Arthur M. Brown's Interest
Years 1918-1923

	TOTAL	Herbert H.Brown's Interest	Arthur M. Brown's Interest	1918	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928
1 Year Business Written in														
1922	107,729.35	25,136.85	82,592.50					41,296.25	41,296.25					
1923	137,213.15		137,213.15						68,606.57	68,606.58				
5 Year Business Written in														
1920	76,509.45	30,603.77	45,905.66			7,650.94	15,301.88	15,301.88	7,650.96					
1921	53,175.81	21,270.32	31,905.49				5,317.58	10,635.16	10,635.16	5,317.59				
1922	71,846.17	16,694.10	54,852.07					9,142.01	18,284.02	18,284.02	9,142.02			
1923	91,706.64		91,706.64						15,284.44	30,568.88	30,568.88	15,284.44		
5 Year Business Written in														
1918	6,275.47	2,510.19	3,765.28	376.53	753.06	753.06	753.06	753.06	376.51					
1919	4,067.93	1,627.17	2,440.76		244.08	488.15	488.15	488.15	488.15	244.08				
1920	3,713.17	1,485.27	2,227.90			222.79	445.58	445.58	445.58	445.58	222.79			
1921	4,291.31	1,716.52	2,574.79				257.48	514.96	514.96	514.96	514.96	257.47		
1922	3,843.22	780.08	2,563.14					256.31	512.63	512.63	512.63	512.63	256.31	
1923	3,804.85		3,804.85						380.49	760.97	760.97	760.97	760.97	380.48
Special 1922	584.80	136.44	448.36					448.36						
Special 1923	3,968.67		3,968.67						3,968.67					
TOTALS	566,760.35	101,687.81	465,072.54	376.53	997.14	9,114.94	22,563.73	78,385.00	168,444.39	125,256.29	41,722.25	16,815.51	1,017.28	380.48

*40% Interest to date of death, July, 1922

(EXHIBIT #20)

(Testimony of Kenneth N. Logan.)

[167] WITNESS.—(Continuing.) The books of Edward Brown & Sons for the years, 1923, 1924, 1925 and 1926—and back to 1918—are on an accrual basis. The entries are not made by showing income and disbursements as cash is actually received and disbursed, but entries are made when business is written, and the amount of commissions and premiums which would be computed on the policies are set up on the books, and the entry made to the commission and premium accounts at that time, irrespective of the date of those payments. The entries with respect to premiums due the home offices and with respect to commissions due Edward Brown & Sons do not relate to the time when actual remittances are made. Current monthly items of expense are set up as paid.

Petitioner's Exhibit No. 20 shows in the first column on the left the year in which policies are written and the length of time for which they run. It is divided into four sections—policies having one year life, three-year policies, five-year policies, and special policies or commissions on special policies. Under the first caption, one year business, we have commissions that apply to policies written in 1922 and 1923. The amounts of commissions are under the column headed total. This paper headed, prorate of overriding commissions of

Arthur M. Brown, from August 1st, 1922, to December 31st, 1923, is a summary of the commissions which accrued on policies written during that time.

[168] Thereupon the document referred to was offered and received in evidence as Petitioner's Exhibit No. 21, was so marked and was and is as follows:

[16]

EDWARD BRO N & SONS

Prorate of Overriding Commissions of Arthur M. Brown
from August 1, 1922 to December 31, 1923

	Total	1922	1923	1924	1925	1926	1927	1928
1 Year Business								
*Written in 1922	44,887.20	9,351.60	35,535.70					
1923	137,213.15		68,606.57	68,606.58				
3 Year Business								
*Written in 1922	29,810.90	2,070.20	9,936.97	9,936.97	7,866.76			
1923	91.706.64		15,284.44	30,568.88	30,568.88	15,284.44		
5 Year Business								
*Written in 1922	1,393.00	58.04	278.60	278.60	278.60	278.60	220.56	
1923	3,804.85		380.49	760.97	760.97	760.97	760.97	
Special	3,968.67		3,968.67					
	312,784.41	11,479.74	133,991.44	110,152.00	39,475.21	16,324.01	981.53	380.48

*From August 1, 1922 to
December 31, 1922.

(EXHIBIT #21)

(Testimony of Kenneth N. Logan.)

[170] WITNESS.—(Continuing.) To the left this is divided into one year, three year and five year groups, indicating the length of time that the policy is to be in force, and the figures all refer to policies written from August 1st, 1922, to the end of 1923. The next column "Total" represents total commissions to accrue on those policies, and represents the total commissions that would be received and retained by Edward Brown & Sons if the policies written during that period went through to their natural expiration without cancellation. The next column headed "1922" represents the amount of commissions which would be earned on an accrual basis in the year, 1922. I am familiar with the form of report required to be made by insurance companies to the Insurance Commissioners of the various states, and referred to in the Revenue Acts of 1924, 1926 and 1928. I am familiar with the method used on those reports for prorating premiums to show when they are earned. On one-year policies the total premium is divided in two, and one-half is considered earned in the current year and one-half in the subsequent year. As to three-year policies earnings are segregated one-sixth to the first year, one-third to the second, one-third to the third, and one-sixth to the fourth, and on five-year business one-tenth to the first year, one-fifth to the second, one-fifth to the third, one-fifth to the fourth, one-fifth to the fifth, and one-tenth to the sixth. In making my prorations I followed that method. I have not prorated over a

(Testimony of Kenneth N. Logan.)

period beyond the year in which the business was written any noncancellable policy. We consider one-year [171] business as being one year or less. Hail insurance is seasonal business. Practically all policies expire on September 15th, and a few on October 15th, and practically none run beyond that. I have not prorated such commissions or any commissions on cargo insurance. The sum of the figures appearing under the heading "1922" and "1923" represent the total as it appears under the "Total" column. The total figure of $44,887.20 allotted $9,351.50 to 1922, and $35,535.70 to 1923 was allotted as follows: 1922 had five months to run. We have taken the ratio of the five months period, which means that an average policy written in that five months period is the two and a half months policy, and have applied to 1922 that proportion, and have carried over the balance to 1923, when the total would expire. That method is the same as used in reports required by Insurance Commissioners and referred to in the Revenue Act. On the next line under one-year business written in 1923 is a total of $137,213.15, representing total commissions accrued to Edward Brown & Sons on one-year business written in 1923. On that line nothing is carried over from under "1922" because the policies did not commence until 1923. Under 1923 I have the figure $68,606.57, and the same with 1¢ difference under 1924. The figures are half the total, so that in 1923 on one year policies we have considered as earned in that year one-half of the

(Testimony of Kenneth N. Logan.)

total on the policies. Using exactly the same method I have, in the same way, shown the total commissions for policies written for three year and for five year business, prorated over succeeding years [172] in the same manner and following the method described by the Insurance Commissioners of the various states.

This paper headed "Prorate of overriding commissions from January 1, 1924, to December 31, 1924, including carry over from August 1, 1922" was prepared by me and under my immediate supervision, and I got the figures from the same source as I got the other figures, except for difference in years. As to this paper and as to Petitioner's Exhibits 21 and 20, and as to the figures in the total columns I have made no change whatever from the figures as they appear on the books of Edward Brown & Sons. The prorates do not appear on the books—the mechanical work of prorating I did. The actual figures used on that basis are exactly the same as appear on the books.

Thereupon the document referred to was offered and received in evidence as Petitioner's Exhibit No. 22, was so marked and was and is as follows:

[173]

EDWARD BROWN & SONS

Prorate of Overriding Commissions from January 1,1924 to December 31,1924
including carry over from August 1, 1922

	Total	1924	1925	1926	1927	1928	1929
Balance from 1923 Schedule							
For year 1924	$110,152.00	$110,152.00					
1925	39,475.21		$ 39,475.21				
1926	16,324.01			$ 16,324.01			
1927	981.53				$ 981.53		
1928	380.48					$ 380.48	
	$167,313.23						
Commissions on Policies written in 1924							
On 1 year Policies	133,507.36	66,753.68	66,753.68				
" 3 year Policies	84,198.80	14,033.13	28,066.27	28,066.26	14,033.14		
" 5 year Policies	1,944.17	194.42	388.83	388.83	388.83	388.83	194.43
Special Commissions	1,211.98	1,211.98					
	$388,175.54	$192,345.21	$134,683.99	$44,779.10	$ 15,403.50	$ 769.31	$ 194.43
Less 1/6 Interest to A.M.Brown, Jr.		32,057.54					
Corrected Earned Commission 1924 of Arthur M. Brown		$160,287.67					
Commission Recorted		$223,721.60					
Svea Farm Profit		694.85	$224,416.45				
Return Commission Dec. 31, 1923		$ 52,971.96					
Return Commission Dec. 31, 1924		49,417.82	3,554.14				
			$220,862.31				
Less 1/6 to A. M. Brown, Jr.			36,810.38				
Commission, per Agent			$184,051.93				
Corrected, as above			160,287.67				
Net Adjustment to Agent's Net Income			$ 23,764.26				

(EXHIBIT #22)

(Testimony of Kenneth N. Logan.)

[174] Petitioner's Exhibit No. 22 shows the unearned proportion of the commission on policies written prior to 1924 carried into 1924 and later years, and in addition commissions on policies written in 1924. From that you can draw off figures which will show the unearned commissons at the end of 1924, commencing with business written after August 1st, 1922. From Exhibit No. 21 the unearned commissions in connection with the business at the beginning of the year, 1923, was $11,479.74. From that exhibit the net commissions accrued for that year would be the total of those three divisions of one, three and five year, and special commissions, which totals $263,693.31. On those figures at the end of 1923 $167,313.23 was earned. This was done by comparing the carry-over into Exhibit 22 and totaling that. The carry-over of unearned commissions at the end of 1923, as shown by Exhibit No. 21, corresponds with the carry-over of unearned commissions that is carried into the year, 1924, on Exhibit No. 22. This paper headed "Edward Brown & Sons. Prorate of overriding commissions from January 1, 1925 to December 31, 1925 including carryover from August 1, 1922," is the same summary for the year, 1925, as Exhibit No. 22 was for the year 1924, prepared in exactly the same way.

Thereupon the document referred to was offered and received in evidence as Petitioner's Exhibit No. 23, was so marked and was and is as follows:

EDWARD BROWN & SONS

Prorate of Overriding Commissions from January 1, 1925 to December 31, 1925
including carry over from August 1, 1922

	Total	1925	1926	1927	1928	1929
Balances from 1924 Schedule for Year 1925	$134,683.99	$134,683.99				
1926	44,779.10		44,779.10			
1927	15,403.50			15,403.50		
1928	769.31				769.31	
1929	194.43					194.43
Commissions on Policies written in 1925						
On 1 year Policies	145,478.88	72,739.44	72,739.44			
" 3 year Policies	92,359.56	15,393.26	30,786.52	30,786.52	15,393.26	
" 5 year Policies	40.89	8.18	8.17	8.18	8.18	8.18
Special Commissions	1,430.65	1,430.65				
	$436,088.51	$224,239.14	$148,296.89	$ 46,181.84	$ 16,154.39	$ 186.25
First one-half Year 1925		$112,119.57				
Less 1/6 to A. M. Brown, Jr.		18,686.59				
			$ 93,432.98			
Second one-half Year 1925		$112,119.57				
Less 1/4 to A. M. Brown, Jr.		28,029.89				
			84,089.68			
Corrected Earned Commission to Arthur M. Brown			$177,522.66			
Commissions 1925		$237,714.69				
Svea Farm Profit		1,779.49	235,935.20			
Return Commission Dec. 31, 1924		$ 49,417.82				
" " " 31, 1925		52,710.80	3,292.98			
			$239,228.18			
Less 5/24 to A. M. Brown, Jr.			49,839.22			
			$189,388.96			
Corrected as above			177,522.66			
Net Adjustment to Agent's Net Income			$ 11,866.30			

(EXHIBIT #23)

(Testimony of Kenneth N. Logan.)

[176] Exhibits Nos. 21, 22 and 23 all carry into the computations a net arrived at after taking care of cancellations and return commissions. On Exhibit No. 23 I have carried in as unearned commissions on business written prior to 1925 the figure shown as unearned commission at the end of 1924 on Exhibit 22, and have then shown the business during 1925 and the commission unearned at the end of 1925.

TESTIMONY OF ARTHUR M. BROWN, IN HIS OWN BEHALF (RECALLED).

The witness was then temporarily withdrawn, and ARTHUR M. BROWN, the petitioner, previously sworn on his own behalf, was recalled and testified as follows:

Direct Examination by Mr. DUNNE.

These papers dated January 1, 1924, January 1, 1927, and January 1, 1929, are the papers I referred to yesterday in discussing my son's participation in the business of Edward Brown & Sons.

Thereupon, all three documents were handed to counsel for respondent for inspection, and the paper dated January 1, 1924, was read in evidence as follows:

"January 1, 1924.

"Salary Agreement Edward Brown & Sons.

"Mr. Arthur M. Brown and Mr. Arthur M. Brown, Jr., [177] doing business as Edward

(Testimony of Arthur M. Brown.)

Brown & Sons hereby agree that from date the joint salaries paid to the partners above named shall be thirty-six thousand dollars per annum, of which Mr. Arthur M. Brown is to received five-sixths or thirty thousand dollars, and Mr. Arthur M. Brown, Jr., is to receive one-sixth, or six thousand dollars.

"ARTHUR M. BROWN.
"ARTHUR M. BROWN, Jr.

WITNESS.—(Continuing.) From my experience in the insurance business I would say that approximately the general ratio of cancellations to business written, depending on the year, runs between 20% and 25%.

Cross-examination by Mr. MEACHAM.

This last exhibit was the only agreement as to partnership between myself and my son, at the time. Prior to January 1, 1927, there was no definite written agreement. He was not a partner in 1923. I think he was a full partner from 1924 on. That was an oral understanding. In 1924 he had a salary interest, and I believe the books will show also an interest in the profits beyond that. In 1923 he had no interest in the profits. It is not my recollection that on my brother's death [178] I took my son into the firm in partnership. To the best of my recollection I would say he was not a partner during 1923.

TESTIMONY OF KENNETH N. LOGAN, FOR PETITIONER (RECALLED).

KENNETH N. LOGAN, previously sworn on behalf of the petitioner, was recalled and testified as follows:

Direct Examination by Mr. DUNNE (Continued).

I have examined the books of Edward Brown & Sons to find what participation in the profits the books reflect. This is a journal used to make the closing entries for each year and is one of the books Mr. White identified as being one of the books of Edward Brown & Sons. The first figure showing the partnership participation of Arthur M. Brown, Jr., is in the closing of the profits for the year, 1924, showing Mr. Brown receiving $21,373.88, Arthur Mr. Brown, Jr., $4,274.77, Mrs. Halton $3,000, and the children of Herbert H. Brown $6,000, making a total closing to profit and loss of $34,648.65. The next entry for closing is for the year, 1925, showing Arthur M. Brown $4,759.90, A. M. Brown, Jr., $1,586.63, Mrs. E. Halton $3,000, children of H. H. Brown $3,000, total $12,346.53, charged to profit and loss. There was a change in rate of participation shown by computation of the closing entries. The exact point of change does not show from these [179] figures. At the end of 1926 the closing figures are A. M. Brown $5,600.43, A. M. Brown, Jr., $1,866.81, and Mrs. E. Halton $2,200. The charge to profit and loss is a total of $9,667.24. The closing entries for

(Testimony of Kenneth N. Logan.)

1923 are charged to profit and loss $11,383.63, credit A. M. Brown, Jr., $2,383.63, children of H. H. Brown $6,000, Mrs. E. Halton $3,000. That is the closing of personal accounts. The final closing of the net profit is charged to profit and loss and to A. M. Brown $7,150.90. Going back to 1922 there is charged to profit and loss $12,432.52, credit A. M. Brown $9,258.19, and no showing of any participation by Arthur M. Brown, Jr. There is another credit of $1,424.33, and a credit to Mrs. E. Halton of $1,750.

A short rate cancellation is a term used in insurance to designate a return premium on cancellations on a basis other than a direct *pro rata* of the premium to the life of the policy and is in favor of the company. Those short rate cancellations have been carried into the figures that I am using, and all of the figures that I can have used as to cancellations are dollars and cents figures and carry with them whatever adjustment is necessarily made because of short rating. This paper headed "Edward Brown & Sons. Prorate of overriding commissions from January 1, 1926, to December 31, 1926, including carry-over from August 1, 1922," is a summary computation I computed from the books for the year, [180] 1926, showing carry-over of unearned commissions from 1925, and the current business written during 1926, prepared on the same basis as Exhibits 21, 22 and 23.

Thereupon the document referred to was offered and received in evidence as Petitioner's Exhibit No. 24, was so marked, and was and is as follows:

[18T

EDWARD BROWN & SONS

Prorate of Overriding Commissions from January 1,1926 to December 31,1926
Including carry over from August 1, 1922

	TOTAL		1926	1927	1928	1929
Balance from 1925 Schedule for 1926	$148,296.89		$148,296.89	$	$	$
1927	46,181.84			46,181.84		
1928	16,154.39				16,154.39	
1929	186.25					186.25
Commissions on business written in 1926						
on 1 year Policies	$141,042.51		$ 70,521.26	$ 70,521.26		
" 3 year Policies	107,929.05		17,988.17	35,976.35	35,976.35	17,988.18
" 5 year Policies	477.08		119.27	119.27	119.27	119.27
Special	6,593.25		6,593.25			
	$465,907.10		$243,280.29	$152,560.18	$ 52,011.47	$ 18,055.16
Less 1/4 to A. M. Brown, Jr.			60,820.07			
Corrected Earned Commission Arthur M. Brown 1926			$182,460.22			
Commissions 1926		$253,881.21				
Sves Farm Profit		741.25	$253,139.96			
Return Commissions Dec. 31, 1925		$ 52,710.80				
" " Dec. 31, 1926		54,658.67	1,947.77			
			$255,087.73			
Less 1/4 to A. M. Brown, Jr.			63,771.93			
Commissions, per Agent's Report			$191,315.80			
Corrected, as above			182,460.22			
Net Adjustment to Agent's Net Income			$ 8,855.58			

(EXHIBIT #24)
209

(Testimony of Kenneth N. Logan.)

[182] WITNESS.—(Continuing.) As to Exhibits 21, 22, 23 and 24, the figures appearing under the word "Total" are the same as the corresponding figures appearing on the books of Edward Brown & Sons. It was not necessary for me to change any figure to make up those exhibits. I simply carried over the figures that appear on the books. Exhibit No. 24 shows the unearned portion of commissions on business written prior to 1926, and since August 1st, 1922, which is attributable to the year, 1926, and shows the portion of the commissions on business written in 1926, which was earned in 1926, and the portion on such business earned in years subsequent to 1926, on the same prorate basis I have already indicated. The unearned commissions at the beginning of the year, 1926, was $210,819.37, the same figure as shown by Exhibit 23 as the unearned commission at the end of 1925. The unearned commission at the end of 1926 was $222,626.81, and the net commission on business written during 1926 $255,087.73.

The closing entry read for December, 1922, of $1,424.33 was for the children of Herbert H. Brown, and the profits show a participation of Arthur M. Brown, Jr., for 1925 of one-fourth. The computations on Exhibit 23 have not been on the basis of one-fourth for Arthur M. Brown, Jr., all the way through, because the internal revenue agent examined the accounts for 1925 and found the interest of Arthur M. Brown, Jr., for the period from [183] January 1, 1925, to July 1, 1925, was a one-

(Testimony of Kenneth N. Logan.)

sixth interest, the same as it had been in 1924, and from July 1, 1925, to December 31, 1925, a one-fourth interest, and we have used those ratios so that the figures are in accordance with the report of the Internal Revenue Department. With reference to Exhibit No. 21 there is no explanation with reference to the participation of Arthur M. Brown, Jr. On Exhibit No. 22, beginning at the lower half, the figures on the line "Less one-sixth interest to Arthur M. Brown, Jr.," represent one-sixth of the total amount of commissions earned in 1924 by Edward Brown & Sons accruing to Arthur M. Brown, Jr. The figures we have been talking about above are total figures for Edward Brown & Sons, and these new figures are for the purpose of arriving at the interest of the taxpayer, the petitioner here. The entry corrected earned commission of 1924 of Arthur M. Brown is the subtraction from total earned commission of the partnership, of Arthur M. Brown, Jr.'s, interest, leaving the petitioner's interest. The figure $223,721.60 under that of commission reported represents the commission reported on the petitioner's personal income tax return for the year, 1924. The figure for "Svea profit" is a separate account not carried under overriding commission on the books but pertaining to the same type of income, and I have prorated that. The figure "Return commission December 31, 1923," represents the liability that was established on the books of Edward Brown & Sons at December 31, 1923, to take care of cancel-

(Testimony of Kenneth N. Logan.)

lations which would accrue, based on five years previous experience. That was a journal entry [184] on the books. Under that I have "Return commission December 31, 1924," which is the same type of figure for return commission liability in effect on December 31, 1924. By using these figures in this schedule we eliminate from the commission account the entry that was put into the commission account to adjust the liability feature as of the beginning and as of the end of the year, so that it leaves only a commission figure in the account. The figure under that, less one-sixth to A. M. Brown, Jr., is one-sixth of the net adjusted commission figure. The next entry, "Commission per agent," is the commission are reported by the revenue agent in his return for that year. Under that, "Corrected, as above," is carrying down the corrected earned commission of Arthur M. Brown for the year, 1924, as compared with the figure used by the agent. The last entry shows the net adjustment between the earned commission as reported in the agent's report and the corrected figure as determined from this schedule. This schedule is computed on the basis of proration of commissions over the period for which they are earned, including the carry-over from August 1, 1922. The figures on Exhibit No. 23 have the same explanation as those on No. 22, except that to bring the proper partnership interests into this schedule we had to divide the commissions into two parts, so that we would get one-sixth for Arthur M. Brown,

(Testimony of Kenneth N. Logan.)

Jr., in the first half of the year, and one-fourth in the second half, and the same is true for Exhibit No. 24, and on all three schedules the ultimate figure arrived at, at the bottom, is the net adjustment to the agent's net [185] income, if the commissions are to be taken on the strict accrual and *pro rata* basis. We have in court the original books of Edward Brown & Son, from which could be taken every figure necessary to make up these exhibits.

This paper headed, "Analysis of commission account," covers the years, 1924, 1925 and 1926, and for each year the same type of figures are set forth, so that if I explain one year I explain all three. In 1924 the first figure is overriding commission of $223,721.60, the figure on the books representing overriding commission in that year, to which I have added "Svea Farm Profit" $694.85, making a total as per the books of $224,416.45, for commissions. The next figure is return commission, December 31, 1923, the liability set up on the books of $52,-971.96, to take care of cancellation of business written in those years, in subsequent years. The next figure, return commission, December 31, 1924, is $49,417.82, set up for the same purpose. The difference between the two is $3,554.14, an entry made on the books reducing the amount of overriding commission in 1924 on the basis that the return commission balance at the beginning of 1923 was in excess of the balance at the end of 1924. The net figure of $220,862.31, therefore, represents the com-

(Testimony of Kenneth N. Logan.)

missions on policies written in the year, 1924, and is in agreement with the figures used by the revenue agent in computing the tax for that year. The purpose of this exhibit is to make corrections to indicate various entries, and to [186] show that the entries in the books tie in with the entries the agent made, and to show that the figures on the books and on the agent's report correspond, assuming both used the same method of computation.

Thereupon, the document referred was offered and received in evidence as Petitioner's Exhibit No. 25, was so marked, and was and is as follows:

PETITIONER'S EXHIBIT No. 25.

[187] ANALYSIS OF COMMISSION ACCOUNT.

1924	Overridnng Commissions.....	$223,721.60		
	Svea Farm Profit	694.85	$224,416.45	
	Return Commission 12/31/23.....	$52,971.96		
	Return Commission 12/31/24.....	49,417.82	3,554.14	
	Net Commission 1924.....			$220,862.31

1925	Overriding Commissions.....	$237,714.69		
	Svea Farm Profit.....	1,779.49	$235,935.20	
	Return Commission 12/31/24.....	$49.417.82		
	Return Commission 12/31/25.....	52,710.80	3,292.98	
				239,228.18
1926	Overriding Commissions.....	253,881.21		
	Svea Farm Profit.....	741.25	$253,139.96	
	Return Commission 12/31/25.....	$52,710.80		
	Return Commission 12/31/26.....	54,658.57	1,947.77	255,087.73

(Testimony of Kenneth N. Logan.)

[188] WITNESS.—(Continuing.) All of the figures on the last exhibit were obtained directly from the book of Edward Brown & Sons and the books are in court. I have prepared a computation of tax for each of the three years, 1923, 1925 and 1926, as it would result by using the so-called prorate method introduced as Exhibits 21 to 24, both inclusive.

Thereupon, the computation referred to was offered in evidence on behalf of the petitioner. To such offer respondent objected.

EXCEPTION No. 4.

Said objection was sustained, and said offer rejected, to which said ruling petitioner then and there duly excepted, and now excepts, and assigns the same as error. The computation so offered and rejected was then marked for identification as Petitioner's Exhibit No. 26 for identification, and was and is as follows:

PETITIONER'S EXHIBIT No. 26.

[189] COMPUTATION OF TAX FOR YEAR 1923.

Total Income as adjusted per 60 day Letter.....		$97,290.56
Less:		
Adjustment for Earned Income.....		
Commission Income per Agent.....	$236,693.31	
As adjusted by prorate.....	133,991.44	
	$102,701.87	
Adjustment for Edith H. Halton.....	3,000.00	105,701.87
Net Loss		$ 8,411.31
No Tax.		
Previously Assessed.....	$ 4,401.20	
Less: 25% Reduction Revenue Act of 1924.....	1,100.30	$ 3,300.90
Refund Due and Interest.		$ 3,300.90

Commissioner of Internal Revenue.

[190] COMPUTATION OF TAX FOR YEAR 1925.

Net Income per 60-Day Letter		$50,737.48	
Less Adjustment—per schedule of Prorated Commissions		11,866.30	
		$38,871.18	
Less Dividends	$3,407.25		
Exemption	3,500.00	6,907.25	
Corrected Net Income		$31,963.93	

TAX COMPUTATION.

Net Income		$31,963.93	
@ 1½%		4,000.00	$ 60.00
		$27,963.93	

@ 3%		4,000.00	120.00
@ 5%		$23,963.93	1,198.19
Surtax:			
$36,000.00	$1,400.00		
2,871.18 @ 10%	287.12		1,687.12
			$3,065.31
Earned Income	$6,739.27		
Less Exemption	3,500.00		
	3,239.27		
@ 1½%	48.58		

25%.....	12.14	12.14
		3,053.17
Less Paid at Source.....		26.90
		3,026.27
Tax Previously Assessed.....		3,470.11
Refund Due.....		443.84

[191] COMPUTATION OF TAX FOR 1926.

Net Income—per 60-Day Letter....		$42,122.48	
Less Adjustment per Prorate Schedule.....		8,855.58	
		$33,266.90	

TAX COMPUTATION.

Corrected Net Income.....			$33,266.90
Less Dividends.....		$3,019.79	
Exemption.....	3,500.00	6,519.79	
		$26,747.11	
@ 1½%.....		4,000.00	$ 60.00
		$22,747.11	
@ 3%.....		4,000.00	120.00
@ 5%.....		$18,747.11	937.35

Surtax:		
$32,000.00	$1,040.00	
1,266.90	114.02	1,154.02
		$2,271.37
Earned Income	$6,142.12	
Less Exemption	3,500.00	
	$2,642.12	
@ 1½%	39.63	
25%	9.91	9.91
		$2,261.46
Less Tax at Source		30.28
		$2,231.18
Previously Assessed		2,600.92
Refund Due plus Interest		$ 369.74

(Testimony of Kenneth N. Logan.)

[192] WITNESS.—(Continuing.) These three papers headed, "Edward Brown & Sons. Prorate of overriding commissions" for various years, "including carry-over from January 1, 1918," are first a summary for the year, 1925, on exactly the same method of computation as in the previous summaries, except that in this case we have gone back to January 1, 1918, to pick up and include in the current year any accrual that might fall in that year on business written in prior years, from 1918. Exhibit No. 20 is made up in exactly the same way except for the years involved, and is for 1923, and goes back to 1918. These other papers which have not yet been marked have the same sort of computation for the years 1924, 1925 and 1926, and as to commission figures, the figures are taken from the books of Edward Brown & Sons, which are here in court.

Thereupon the documents referred to were offered and received in evidence as Petitioner's Exhibit No. 27, was so marked, and was and are as follows:

[1937]

EDWARD BROWN & SONS

Prorate of Overriding Commissions from January 1, 1924 to December 31, 1924
including carry over from January 1, 1918

Balance from 1923 schedule	TOTAL	1924	1925	1926	1927	1928	1929
For Year 1924	$125,255.29	$125,255.29	$	$	$	$	$
1925	41,722.25		41,722.25				
1926	16,816.51			16,816.51			
1927	1,017.28				1,017.28		
1928	380.48					380.48	
Commissions on Policies written in 1924:							
On 1 year Policies	133,507.36	66,753.68	66,753.68				
3 year Policies	84,198.80	14,033.13	28,066.27	28,066.26	14,033.14		
5 year Policies	1,944.17	194.42	388.83	388.83	388.83	388.83	194.43
Special Commissions	1,211.98	1,211.98					
	$406,053.12	$207,448.50	$136,931.03	$ 45,270.60	$15,439.25	$ 769.31	$ 194.43
Less 1/6 to A.M.Brown, Jr.		34,574.75					
Corrected Earned Commission of A. M. Brown for 1924		$172,873.75					

Adjustment to Net Income:

Commissions 1924	$223,721.60	
Even Farm Profits	694.86	$224,416.46
Return Commission Dec. 31, 1923	$ 52,971.96	
" " Dec. 31, 1924	49,417.82	3,554.14
		$220,862.31
Less 1/6 to A. M. Brown, Jr.		36,810.38
		$184,051.93
Commission, per Agent Corrected, as above		172,873.75
		$ 11,178.18

EXHIBIT #27 (1)

EDWARD BROWN & SONS

Prorate of Overriding Commissions from January 1 to December 31, 1925
Including carry over from January 1, 1918

	Totals	1925	1926	1927	1928	1929
Balances from 1924 Schedule						
For 1925	$136,931.03	$136,931.03	$		$	$
1926	45,270.60		45,270.60			
1927	15,439.25			15,439.25		
1928	769.31				769.31	
1929	194.43					194.43
	$198,604.62					
Commission on Business written in 1925 on -						
1 Year Policies	145,478.88	72,739.44	72,739.44			
3 " "	92,359.66	15,393.26	30,786.52	30,786.52	15,393.26	
5 " "	40.89	8.18	8.17	8.18	8.18	8.18
Special	1,430.63	1,430.63				
	$437,832.80	$226,486.18	$148,788.39	$ 46,217.69	$16,154.39	$ 186.25

First one-half year 1925	$113,243.09	
Less 1/6 to A.M.Brown, Jr.	18,873.85	94,369.24
Second one-half Year 1925	$113,243.09	
Less 1/4 to A.M.Brown, Jr.	28,310.77	84,932.32
Corrected Earned Commissions Arthur M. Brown in 1925		$179,301.56
Commissions 1925	$237,714.69	
Svea Farm Profit	1,779.49	$235,935.20
Return Commission Dec.31,1924	$ 49,417.82	
Return Commission Dec.31,1925	52,710.80	3,292.98
		$239,228.18
Less 5/24 to A. M. Brown, Jr.		49,839.22
		$189,388.96
Corrected, as above		179,301.56
Net adjustment to Agent's Net Income		$ 10,087.40

EXHIBIT #27 (2)

228
[1957]

EDWARD BROWN & SONS

Prorate of Overriding Commissions from January 1, 1926 to December 31, 1926
including carry over from January 1, 1918

	Totals		1926	1927	1928	1929
Balance from 1925 Schedule for 1926	$148,788.39		$148,788.39	$	$	$
1927	46,217.59			46,217.59		
1928	16,184.39				16,184.39	
1929	186.25					186.25
Commissions on Business Written in 1926						
on 1 year Policies	141,042.51		70,521.25	70,521.26		
" 3 " "	107,929.05		17,988.17	35,976.35	35,976.35	17,988.18
" 5 " "	477.08		119.27	119.27	119.27	119.27
Special Commissions	6,593.25		6,593.25			
	$466,434.35		$243,771.79	$152,595.93	$ 52,011.47	$ 18,055.16
Less- 1/4 to A. M. Brown, Jr.			60,942.95			
Corrected Earned Income Arthur M. Brown			$182,828.84			
Commissions 1926		$253,881.21				
Over Farm Profit		741.25	$253,139.96			
Return Commission Dec. 31, 1925		$ 52,710.80				
" " Dec. 31, 1926		54,658.57	1,947.77			
			$255,087.73			
Less 1/4 to A. M. Brown, Jr.			63,771.93			
Commissions, per Agent's Report			$191,315.80			
Corrected, as above			182,828.84			
Net Adjustment to Agent's Net Income			$ 8,486.96			

EXHIBIT #27 (3)

(Testimony of Kenneth N. Logan.)

[196] WITNESS. — (Continuing.) Exhibits No. 20 and No. 27 differ from Exhibits Nos. 21, 22, 23 and 24, in that the latter contemplate that the carry-over commences as of August 1, 1922, and prorates for earned commissions have been based on the carry-over for that period only. In Exhibits Nos. 20 and 27 we go back to 1918 to pick up any accruals that would fall in the year 1923 or subsequent years, and have taken the five year policies written in 1918. I have determined how much of the commissions with respect to those policies was unearned at the beginning of 1923 or subsequent years. On three-year business I have gone back to 1920 and picked up such part of the commission on business written in that year as was earned in 1923 or later. From 1918 I have included subsequent years on five year business, and on three year business from 1920 on. As to one year business I have included the proper proportion written in 1922 and prior to August 1, 1922, and have corrected the figures to take care of the participation of Herbert H. Brown in such parts of the commissions as were earned before his death, and have arrived at a net figure for Arthur M. Brown. For the years after 1923 I have followed the same method with respect to the interest of Arthur M. Brown, Jr., as already indicated on Exhibits Nos. 21, 22, 23 and 24. The only difference between Exhibits Nos. 20 and 27, upon the one hand, and Nos. 21, 22, 23 and 24, upon the other, is that in the former I have computed the

(Testimony of Kenneth N. Logan.)

[197] earned commission for the years in question on all policies in force during those years, but in Exhibits Nos. 21, 22, 23 and 24, I have assumed that it was only necessary to go back to the date of the death of Herbert H. Brown to pick up unearned carry-over for the subsequent years. I have a computation of the tax for these exhibits.

Thereupon the computation referred to was offered in evidence on behalf of the petitioner, and to such offer respondent objected.

EXCEPTION No. 5.

Said objection was sustained, and said offer rejected, to which said ruling petitioner then and there duly excepted, and now excepts, and assigns the same as error. The computations so offered and rejected was then marked for identification as Petitioner's Exhibit No. 28 for identification, and was and is as follows:

PETITIONER'S EXHIBIT No. 28.

[198] COMPUTATION OF TAX FOR YEAR 1923.

Total Income as adjusted per 60 day Letter		$97,290.56
Less:		
Adjustment for Earned Income		
Commission Income per agent	$236,693.31	
As adjusted by prorate	168,444.39	
	$ 68,248.92	
Adjustment for Edith H. Halton	3,000.00	65,248.92
Corrected Total Income		$32,041.64
Less: Dividend	$4,479.20	
Exemption	2,000.00	6,479.20

Amount subject to Normal Tax.....		$25,562,44
Tax.....	$25,562.44	
@ 4%.....	4,000.00	160.00
@ 8%.....	$21,562.44	1,725.00
Surtax.....		1,706.25
		$3,591.25
Less: 25% reduction.....		
Revenue Act 1924.....		922.81
		$2,668.44
Tax Originally Assessed.....	$4,401.20	
Less: 25% reduction.....		
Revenue Act 1924.....	1,100.30	3,300.90
Refund Due and Interest.....		$ 632.46

[199] COMPUTATION OF TAX FOR YEAR 1925.

Net Income per 60-Day Letter		$50,737.48
Less Adjustment—per Schedule of Prorated Commissions		10,087.40
Corrected Net Income		$40,650.08

TAX COMPUTATION.

Net Income		$40,650.08
Less Dividends	$3,407.25	
Exemptions	3,500.00	6,907.25
Subject to Normal Tax		$33,742.83

@ 1½%		4,000.00	$ 60.00
		$29,742.83	
@ 3%		4,000.00	120.00
@ 5%		$25,742.83	1,287.14
Surtax:			
$40,000.00	$1,800.00		
650.08 @ 11%	71.51		1,871.51
			3,338.65
Earned Income	$6,774.85		

Less Personal Exemption.....	3,500.00	
	$3,274.85	
Tax @ 1½%.....	49.11	
25%.....	12.28	12.28
		3,326.37
Less Tax Paid at Source.....		26.90
		3,299.47
Tax Previously Assessed.....		3,470.11
Refund due and Interest.....		170.64

[200] COMPUTATION OF TAX FOR YEAR

1926.

Net Income per 60-day letter.....		$42,122.48
Less Adjustment per Prorate Schedule...		8,486.96
Adjusted Net Income.....		$33,635.52

TAX COMPUTATION.

Net Income.....		$33,635.52
Less—Dividends.....	$3,019.79	
Exemption.....	3,500.00	6,519.79
		$27,115.73

@ 1½%		4,000.00	60.00
		$23,115.73	
3%		4,000.00	120.00
		$19,115.73	
5%			955.78
Surtax:			
$32,000.00	$1,040.00		
1,635.52 @ 9%	147.20		1,187.20
			$2,322.98

Earned Income Credit	$6,215.85	
Less Exemption	3,500.00	
	2,715.85	
@ 1½%	40.74	
25%	10.18	10.18
		$2,312.80
Less Tax Paid at Source		30.28
		$2,282.52
Tax Previously Assessed		$2,600.92
Refund Due plus Interest		$ 318.40

(Testimony of Kenneth N. Logan.)

[201] WITNESS.—(Continuing.) This paper headed "Edward Brown & Sons. Basis for establishing cancellation liability December 31, 1922," is a computation adjustment made on the same basis as that made on the books of Edward Brown & Sons, December 31, 1923, settling up a liability for cancellations that would take effect in subsequent years on business written and in force during 1922. In other words, it gives the balance at the beginning of the year, 1923, on the same basis as the closing balance for similar liability at the end of the 1923. I have arrived at the figure from past experience of the ratio of cancellations to business written. I got the figures from the books of Edward Brown & Sons, and the ratio of cancellation to business written was 23.06%. I then computed the amount of cancellations likely to occur with respect to business written in 1922, using that ratio and setting up figures which would take care of cancellations that would occur in 1923 and later years on business written in 1922. The books of Edward Brown & Sons show the net commissions during the year, and show a deduction by way of a figure to take care of cancellations and necessary return commission. If that was what the books would show that would amount to a double deduction because my figures for commission during 1923 was the net figure—it is the gross premiums less return premiums, less reinsurance, plus reinsurance cancellation, known in insurance terms as net premiums. The computation [202] is made to set up a figure which past experi-

(Testimony of Kenneth N. Logan.)

ence has shown will be a liability to Edward Brown & Sons to return commissions on business cancelled in subsequent years. This computation is for the purpose of avoiding any double deduction. This last exhibit represents figures taken off the books, and these are calculations from those figures on the basis I have just explained.

Thereupon the document referred to was offered and received in evidence, was marked Petitioner's Exhibit No. 29, and was and is as follows:

PETITIONER'S EXHIBIT No. 29.

[203] EDWARD BROWN & SONS.

Basis for
Establishing Cancellation Liability December 31, 1922,
Arthur M. Brown's Interest
in Total Commissions Written 1922.

Basis for Return Commission Liability for year 1922 on similar basis as used in 1923:

	Fire Premiums	Fire Cancellations
1918	$2,275,515	$480.616
1919	2,755,436	643,409
1920	3,383,810	814,200
1921	2,714,243	678,669
1922	2,702,822	572,894
	13,831,726	3,189,788

Ratio.	23.06%	
Total Fire Overriding Commissions for 1922		182,033.92
7/12 written during Partnership	106,186.43	
Herbert H. Brown's Interest 40%		42,474.57
		139,559.35
23.06% for Cancellations		32,182.39
Allowance carried forward December 31, 1922		32,182.39
Overriding Commissions 1923		236,693.31
		268,875.70
Less—Allowance for Cancellations December 31, 1923		52,971.96
Corrected		215,903.74

Originally Reported	236,693.31	
Less Allowance	52,971.96	
		183,721.35
		32,182.39
Agent		236,693.31
As above		215,903.74
		20,789.57

(Testimony of Kenneth N. Logan.)

[204] WITNESS.—(Continuing.) This (referring to paper) is a similar computation for the purpose of computing what the cancellation set up should be on commissions carried over to subsequent years, going back to August 1, 1922, on the same basis and for the same purpose as the last exhibit.

Thereupon the document referred to was offered and received in evidence as Petitioner's Exhibit No. 30, was so marked and was and is as follows:

PETITIONER'S EXHIBIT No. 30.

[205] EDWARD BROWN & SONS.

Basis for
Establishing Cancellation Liability December 31, 1922.

Arthur M. Brown's Interest
from August 1, 1922 to December 31, 1922.

Ratio of premiums to Cancellations for Years 1918–1922 (see other schedule)		23.06%
Commissions written 1922	182,033.92	
7/12 written during Partnership	106,186.43	
		75,847.49
23.06% for Cancellations to 1923		17,490.43
Overriding Commission 1923	236,693.31	
		254,183.74

(Testimony of Kenneth N. Logan.)

Less Allowance for Cancellations carried to 1924	52,971.96
	201,211.78
Agent's Report	236,693.31
	35,481.53

[206] These last exhibits do not take into account prorating the income on any premium basis or any commission basis related to premiums on the basis of the time in which they are earned. Exhibits 20 to 27, inclusive, are on an actual basis, taking the actual figures of commissions as shown on the books, and prorating them for the years in which they were earned. These last figures, taking the net commissions for any one year, as shown on the books, and with proper adjustments at the beginning and end of the year, set up a figure which the experience of the books shows is likely to be the cancellations from those commissions in future years. It does not attempt to prorate the income for the actual periods in which it was earned. The purpose is simply to produce a figure, which will be the ultimate earnings if the past experience holds true with Edward Brown & Sons' commissions written for the particular year. I have the computation of the journal entry made in December, 1923, setting up the liability. This is a copy. The original is here in court.

Thereupon the original journal entry was pro-

(Testimony of Kenneth N. Logan.)

duced and exhibited to counsel for respondent, and the copy was offered and received in evidence as Petitioner's Exhibit No. 31, was so marked, and was and is as follows:

PETITIONER'S EXHIBIT No. 31.

[207] "A. Commission Overriding $52,971.96

A. To return Commission $52,971.96

	Fire Prems.	Fire Canc.
1919	2,755,436	643,409
1920	3,383,810	814,200
1921	2,714,243	687,669
1922	2,702,822	572,894
1923	3,336,711	623,932
	14,893,022	3,333,104

Ratio 22.38.

Total Fire Aver. Comm. for 1923—$236,693.31."

A photostatic copy of the page of the journal containing the foregoing entry was subsequently offered and received in evidence as part of Petitioner's Exhibit No. 32, and it is prayed that the original exhibit, to wit, the said photastatic copy, be forwarded to the Circuit Court of Appeals for the Ninth Circuit with the transcript herein, and as part of the record on appeal.

WITNESS.—(Continuing.) The books of Edward Brown & Sons for the year, 1923, show a figure for commissions earned, less this figure computed on

(Testimony of Kenneth N. Logan.)

the basis of experience. That figure represents the difference between the return made by Arthur M. Brown, as corrected for all deductions, and the basis upon which the deficiency was assessed by the Commissioner, with the exception of the Halton matter and the item of credits between the taxpayer and the Department. With the exception of the $3,000 in the [208] Halton matter the total difference between the basis of computing the deficiency by the Commissioner and the taxpayer is represented by that one figure. Similar figures were set up for 1924, 1925 and 1926. Those figures were set up when there was a carry-over at the beginning of each of those years from the figure set up at the end of the preceding year, and cancellations during those years were charged back against the figures set up for the beginning of the year, so that after 1923 the only figure in difference between the taxpayer and the respondent is, not the total of the figure set up, but the difference between the figure at the beginning of the year and at the end of the year—that is, the net adjustment to that account. Those figures are included in that reconciliation of the books to the agent's report in 1924, 1925 and 1926, 1923 being the full liability figures. Exhibit No. 29 refers only to 1923. These net adjustments we have just been speaking about and their computations are shown on Exhibit No. 25. On the basis of Exhibits 20 and 27—on the accrual basis of prorating commissions for the year in which earned, and going back and picking up the five year busi-

(Testimony of Kenneth N. Logan.)

ness in 1918, the three year business from 1920, and the one year business for the whole of 1922, the figures showing the unearned commissions at the beginning of 1923 appear on Exhibit 20, and the total is $80,204.22. That figure was arrived at by taking the carry-over at the beginning of the year, 1922, and falling in 1923—that is, by taking business written in the years, 1918 to 1922, which [209] was earned in 1923, as shown by the column "1923" on Exhibit 20. The total of that column is $168,444, of which $80,204.22 is carried over from previous years, and $88,240.17 is for the current year, 1923. The method of computing that is simply taking in the first column which shows the year in which the policy was written. If that is a date prior to the current year date, then that figure is the one to be used in the year in which the carry-over is desired.

Q. That would be the same as the commission for those respective years on Exhibits 21, 22, 23 and 24; that figure will not change, will it? A. No.

The unearned commission at the end of 1923 is $185,190.81.

Thereupon there was produced and identified journal entries from the journal of Edward Brown & Sons for December, 1924, December, 1925, and December, 1926, and by stipulation photostatic copies were substituted for the originals and were offered and received in evidence, together with a photostatic copy of the journal entry for December, 1923, as Petitioner's Exhibit No. 32, and the same was so marked. It is prayed that the original of said exhibit, to wit, said photostatic copies, be forwarded

to the Circuit Court of Appeals for the Ninth Circuit with the transcript herein and as part of the record on appeal. Said entries so far as germane to the matters in issue here were and are as follows:

PETITIONER'S EXHIBIT No. 32.

[210] DECEMBER, 1924.

" * * *

A. Commission Overriding 49,417.82

A. To Return Comm. 49,417.82

	Fire Prems.	Fire Canc.
1920	3,383,810	814,200
1921	2,714,243	678,669
1922	2,702,822	572,894
1923	3,336,711	623,932
1924	3,509,896	802,406
	15,647,482	3,492,101

Ratio 22.32.

Total Fire Over. Comm. for 1924 $221,406.02."

DECEMBER, 1925.

" * * *

A. Commission Overriding 52,710.80

A. To Return Comm. 52,710.80

	Fire Prems.	Fire Canc.
1921	2,714,243	678,669
1922	2,702,822	572,894
1923	3,336,711	623,932

(Testimony of Kenneth N. Logan.)

1924	3,509,896	802,406
1925	3,667,771	754,769
	15,931,443	3,432,670

Ratio 21.55.

Total Fire Overriding Comm. for 1925—$244,-597.68."

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[211] DECEMBER, 1926.

" * * *

A. Commission Overriding	54,658.57	
A. To Return Comm.		54,658.57

	Fire Premiums.	Fire Canc.
1922	2,702,822	572,894
1923	3,336,711	623,932
1924	3,509,896	802,406
1925	3,667,771	754,769
1926	3,938,159	870,070
	17,155,359	3,624,071

Ratio 21.13.

Total Fire Overriding Comm. for 1926—$258,-677.57."

WITNESS.—(Continuing.) The figures from which the ratio was computed were taken from the books of Edward Brown & Sons and show their experience. The figures on which my computations have been based are the figures which I have taken from the books of Edward Brown & Sons, and the

(Testimony of Kenneth N. Logan.)

additional figures which appear as my computations are simply mathematical computations made by me from those figures. In order to make the mathematical computations it was not necessary to go back and set up the books in any different way. The system of the books kept by Edward Brown & Sons as a whole is on the accrual method, which is the accepted [212] basis for computing income of a general agent.

Cross-examination by Mr. MEACHAM.

I have been acquainted with the books and records and accounts of Edward Brown & Sons since 1924. Our firm has handled accounts for Arthur M. Brown prior to that time, but I personally did not. Our first work during 1924 was on the accounts for 1920. I was in Edward Brown & Sons office during 1924 probably a half dozen times spread out over the year, for replies to certain revenue department examinations of income tax. It was activity of Government agents which resulted in my employment. We had no supervision of the books. We examined them for certain specific things. We do not construct the books ourselves. Frequently certified public accountants supervise the entire bookkeeping system and prepare and file returns, but that was not our employment with the petitioner in this case. The books of Edward Brown & Sons during the taxable years in question were kept on the theory which I arrived at in 1927. I would say that the returns filed by the petitioner for the years involved

(Testimony of Kenneth N. Logan.)

were not filed in accordance with this theory. If the Board should decide that our theory in reference to prorating earned commissions was proper the returns would have to be amended. I have never personally made any entries in the books of petitioner, nor directly or indirectly suggested any changes, corrections, alterations or erasures in the books for the years as to which I directed my testimony. Partnership and corporations [213] are two different entities. The theory of accounting would not differ as to them though the application of it to the particular problem might. The method which I referred to this morning of reporting income for a period over five years would require an extension beyond the time during which the partnership might exist, or a proper consideration could be taken at the time that the partnership ceases. We would not have to guess or apply experience tables to find the unearned portion of the commission, but could do it by accrual computation of the unearned premium. That does not include any experience tables. I have been over the books, records, ledgers and documents as to which I have testified, as to all matters pertinent to the issues here, and I have had assistance under my supervision. I myself noticed a change in the item setting up the journal entry for the liability of cancellation for December 31, 1923. That change had been made the first time I saw the entry, and on inquiry found that they put the wrong item—I believe a credit item—on the wrong line and erased

(Testimony of Kenneth N. Logan.)

it. The typewritten copy does not show the change. I was informed that before the change the words "Commission Overriding" were where the words "Return Commissions" now are. If you search through the books you might find a good many other changes. I believe that that entry is in the handwriting of a Mrs. or Miss Anderson, who is now living and employed by the petitioner. I don't know when the change was made.

Mr. DUNNE.—Would you like to have her out here, Counsel?

[214] Mr. MEACHAM.—Well, unless I can satisfy myself, for the purpose of the record as to the change, it may be necessary to get her here to find out what—

The WITNESS.—The change was made at the time—prior to the time that the revenue agent came in, because he shows the same entry in his return.

WITNESS.—(Continuing.) The agent's report is dated May 6th, 1927, and he came in some time before then. The entry you will find posted in the books to the same account. They did not prorate the commissions on the books. In my opinion no change in the basis of the filing of the returns or the basis of accounting was necessary. I have my personal fee in this case but no other financial interest in its outcome. Edward Brown & Sons have in addition to commission income, income from a percentage of the profits made by the insurance company on the business written in the territory

(Testimony of Kenneth N. Logan.)

of Edward Brown & Sons. That is not commission. The income from the commissions has been computed on what is known in the insurance world as the net premiums—the net business written for a year. The income tax return was not made in accordance with that, but on the basis of net commissions on premiums less allowance for cancellations in future years. The returns are in accordance with the books and on the same basis that the books have kept on. During 1923 when the figure of $52,971.96 was set up, it was set up not as a reserve but as an established liability for return commissions which would have to be repaid to the insurance companies [215] upon cancellation. This type would not be called a reserve. I call it a liability, to establish on the books a figure to be returned to the insurance companies on the cancellation of policies which would effect a return of commission. During 1923 we also deducted the amount actually returned during that year. We had this figure for the purpose of deducting that amount returned to insurance companies in later years. We did not have a double check on that return commission because the cancellation against which this liability is established had not, at that point, been made. The cancellation is to take effect in later years. That was set up in December, 1923, for the first time. We did not know the exact amount until it was actually paid out. This amount of $52,971.96 seemed adequate from the experience of the past five years. It might have been 2/3*ds* of

(Testimony of Kenneth N. Logan.)

that if the current year differed from the previous years. The amount to be deducted depends on the amount of the commissions returned. If that was $25,000 the liability figure would have that much deducted from it. There is a contingency there—you cannot foresee actually as to the definite amounts. It is a contingent liability based on the experience of the five years preceding. Some commission income is deferred on the books of Edward Brown & Sons to later years through the medium of this liability set up on the books, but aside from that all commissions are included in profit and loss during the year when the business is written. On Exhibit No. 25 we have 1924, 1925 [216] and 1926, but not 1923, because that year did not have a return commission account, and the only figure deducted from overriding commission is the $52,971.96 set up at the end of 1923 for carry-over of commissions. The total gross income from commissions is composed of commissions on policies written during the year, less a liability established at the end of the year for anticipated cancellation in subsequent years, plus the liability established at the beginning of the year for cancellations to take effect in that and subsequent years. That is without regard to the length of the policy. In some years Arthur M. Brown, Jr., was a partner. The status of Mrs. Halton has already been explained. The entry to the children of Herbert H. Brown is a charge to Arthur M. Brown and undeductible. In 1923 there were no partners and only

(Testimony of Kenneth N. Logan.)

an individual return was filed. In 1925 and 1926 there were two partners, Mr. Brown and his son, and Mrs. Halton, a sort of limited partner, having an interest to the extent of a specified amount. She had no interest other than the receipt of $3,000 a year. When policies are short rated that is in favor of the company because the company receives a larger proportion of the premium during the time the policy was in force than it would have for the same period had the insurance been permitted to continue. If the policy has run half its length, and the assured cancels, the company gets more than half the total premium. That does not apply to cancellations by the insurance companies —there they return the full *pro rata* of the premium. Edward Brown & Sons [217] are general agents, and their income is partly from commissions. They do not receive premiums. An insurance company receives premiums, and the agent receives commissions.

Redirect Examination by Mr. DUNNE.

It was stipulated as to the journal entry for December 31, 1923 (Petitioner's Exhibit No. 31 and the 1923 sheet of Petitioner's Exhibit No. 32), had not been changed as to any figure as distinguished from a letter in a word, and that the only change was in a heading; that the first line reads "Commission Overriding" with the figure $52,971.96, and the next line starts with "To" that has not been changed, and that as to the next two

(Testimony of Kenneth N. Logan.)

words "Return Commissions" there has been an erasure, and that there was no other change.

WITNESS.—(Continuing.) With reference to whether or not permission was ever asked to change the basis of making the return, I will say that no change has been made in the method of keeping the books of account, and they were kept for that year, 1923, and following, in the same manner as they were kept for the preceding years back to 1918—that is, the accrual method. The fee which I will get for services here will not in any way be affected by the outcome of this case—it is not contingent. With regard to the contingent profit account of Edward Brown & Sons no earnings resulting therefrom and from participation in the profits of their companies have in any form entered into any figure we are using. We are [218] dealing simply with the overriding commission—the commission that is earned over the life of the policy. In speaking of contingent liability for return commissions the only thing that I mean was contingent was the exact amount. After the years in question there have been calculations, and those calculations very closely approximated the figure arrived at by using this ratio, but I have not computed the exact amount.

Thereupon petitioner rested, and respondent having no evidence to offer likewise rested.

Thereupon petitioner moved for judgment that the items in issue were proper deductions, and that as to the matter of commissions petitioner be

permitted first to return his income for the years in question on the accrual basis, *pro rata* basis, returning in each year only the overriding commission earned in that year, carrying into those computations for commissions earned in 1923, and subsequent years, only the unearned part of the commissions on business written from August 1st, 1922, and following, after the death of Herbert H. Brown, or if that is denied then on the same basis but including actual carry-over of unearned commission into the years in question from the inception of any policies in force during those years, or if that is denied, that petitioner be permitted to return his tax for the years in question [219] by showing his income for those years and setting up as against it a figure representing the liability included and connected with those commissions, to return the proportionate commission in future years that will correspond with the unearned part of the premium in the event of cancellation of the policy, in other words, upon the basis upon which the returns were actually made but with proper connection for reserves at the beginning of the tax years.

EXCEPTION No. 6.

The matter was thereupon submitted and briefs filed by both parties, and the said motion was denied, and findings and judgment made, promulgated and entered in favor of respondent, as more fully appears from the findings, opinion and judgments herein, to which said ruling and to which

findings, opinion and judgments, petitioner duly excepted and now excepts and assigns the same as error.

The foregoing is a full, true and correct, concise statement of all of the evidence in the above-entitled matters, and contains all of the evidence offered or introduced on the trial of the above matters and all proceedings on the trial of the above matters, and except as to the pleadings, there was no matter, happening or showing before the Honorable, The United States Board of Tax Appeals [220] in making its determinations in the above-entitled matters, except as herein set out.

And now, agreeable to the provisions of law and the rules of the Honorable, the United States Circuit Court of Appeals for the Ninth Circuit, in such cases made and provided, and within the time allowed by law and by the rules of said court and orders of said court made herein, petitioner presents and lodges the foregoing statement of the evidence for examination by respondent and approval by the Honorable, the United States Board of Tax Appeals; and

Petitioner prays that all of the exhibits herein be deemed a part of the foregoing statement of the evidence and be, by the Clerk of the United States Board of Tax Appeals, attached to the transcript of record on appeal and review, and as such be forwarded to the Circuit Court of Appeals of the United States, for the Ninth Circuit, and that the foregoing statement of evidence be allowed, settled and approved

as such, and for all purposes for which a statement of evidence may be used, to the end that the foregoing matters may be made matter of record.

Dated at San Francisco, California, December 11th, 1931.

ARTHUR B. DUNNE,
Attorney for Petitioner.
KENNETH N. LOGAN,
Accountant for Petitioner.

[221] STIPULATION AS TO SETTLEMENT OF STATEMENT OF EVIDENCE.

IT IS STIPULATED by the parties hereto that all of the exhibits offered in evidence on the trial of the above-entitled matters, including those offered and not received in evidence, but marked for identification, be considered a part of the foregoing statement of evidence, attached to the transcript of record on appeal and review, and with said transcript and the foregoing statement of evidence, be forwarded to the United States Circuit Court of Appeals for the Ninth Circuit, and that the United States Board of Tax Appeals may make its order accordingly and it is further stipulated that the foregoing is a full, true and correct statement of all of the evidence offered, and offered and received, as therein appears, and a correct statement of all of the proceedings had on the trial of the above-entitled matters, and that there was no matter, happening or showing before the said United States Board of Tax Appeals, other than the pleadings, except as

therein shown, and that the same may be settled, approved and allowed, and the prayer thereof granted.

Dated at San Francisco, California, December 11th, 1931.

ARTHUR B. DUNNE,
Attorney for Petitioner.

[222] KENNETH N. LOGAN,
Accountant for Petitioner.

Dated at Washington, D. C., ————, 193—.

————————,
General Counsel, Bureau of Internal Revenue.

ORDER SETTLING STATEMENT OF EVIDENCE.

I, John J. Marquette, certify that I am a member of the United States Board of Tax Appeals, and the member before whom the above-entitled matters were tried, and the member who made the findings of fact and promulgated the opinion therein, and that all of the proceedings recited in the foregoing statement of evidence were had before me; that the foregoing statement was served and lodged herein, and settled and allowed, within the time allowed by law, and the rules of the United States Circuit Court of Appeals for the Ninth Circuit, as extended by orders of the United States Circuit Court of Appeals for the Ninth Circuit, [223] and, accordingly,

IT IS HEREBY ORDERED, that the prayer of said statement be, and the same is, hereby granted, and the foregoing stipulation thereto be, and the same is, hereby approved, and it is hereby ordered

accordingly, and it is further ordered that all of the exhibits in the above-entitled matters, including those offered and not received in evidence, but marked for identification, be considered a part of the foregoing statement of evidence, attached to the transcript of record on appeal and review, and be forwarded to the United States Circuit Court of Appeals for the Ninth Circuit, with said transcript, and it is further ordered and adjudged, that the foregoing is a full, true and correct statement of all of the evidence offered, and offered and received, as therein appears, and a correct statement of all of the proceedings had on the trial of the above-entitled matters, and that there was no matter, happening or showing before the United States Board of Tax Appeals, other than the pleadings, except as therein shown, and that the same be, and it is, hereby approved, settled and allowed, and be filed and be made a part of the record herein and transmitted to the United States Circuit Court of Appeals for the Ninth Circuit, accordingly.

Dated January 21st, 1932.

JOHN J. MARQUETTE,
Member, United States Board of Tax Appeals.

[402] Filed Jan. 6, 1932.

United States Board of Tax Appeals.

Three proceedings entitled as here, and numbered respectively as follows:

DOCKET No. 35,305.

DOCKET No. 39,157.

DOCKET No. 43,432.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PRAECIPE FOR PREPARATION OF TRANSCRIPT OF RECORD ON APPEAL.

To the United States Board of Tax Appeals, and to the Clerk Thereof:

You are requested to make up a transcript in the above-entitled matters, to be forwarded to the United States Circuit Court of Appeals for the Ninth Circuit, for use on petitioner's petition for review of the decisions of the United States Board of Tax Appeals in the above-entitled matters, and you are requested to include in said transcript and to duly certify as correct and transmit to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, at the Post Office Building, 7th and Mission Streets, San Francisco, California, copies of the following documents:

[403] 1. The docket entries in all of said causes of proceedings before the United States Board of Tax Appeals.

2. The pleadings in all of said causes before the United States Board of Tax Appeals.

3. The findings of fact, opinion and decisions of the United States Board of Tax Appeals.

4. Petitions for review filed by petitioner above named, in each of said matters.

5. Notices of filing of petitions for review.

6. When the same shall have been settled, allowed and approved and allowed, the consolidated statement of evidence settled or agreed upon in the above-entitled matters.

7. Stipulation and order in each of the above matters, for consolidation of the same on appeal.

8. Copies of all orders enlarging the time of petitioner for preparation, approval and filing of his statement of evidence, and for the preparation and transmission of the transcript herein and for the docketing of the cause in the United States Circuit Court of Appeals for the Ninth Circuit, not included in record.

9. All exhibits offered and received in evidence or marked for identification. (Exs. 3, 4 to 8, inc., 14, 20 to 31, inc., included in statement of evidence.)

10. This praecipe.

11. Affidavit of A. B. Dunne proving service.

Dated: December 31st, 1931.

ARTHUR B. DUNNE,
Attorney for Petitioner,
920 Insurance Exchange Building,
San Francisco, California.
KENNETH N. LOGAN,
Accountant for Petitioner,
Balfour Building, San Francisco,
California.

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[404] Filed Jan. 6, 1932.

United States Board of Tax Appeals.

Three proceedings entitled as here, and numbered respectively as follows:

DOCKET No. 35,305.

DOCKET No. 39,157.

DOCKET No. 43,432.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

AFFIDAVIT OF ARTHUR B. DUNNE AS TO SERVICE OF PAPERS.

Arthur B. Dunne, being first duly sworn, deposes and says:

That he served upon respondent above named by service on the attorney for respondent, the papers hereinafter specified, and served the same by mail,

the same being mailed on the dates hereinafter specified; that each of said papers was served by enclosing the same in a sealed envelope, addressed "C. M. Charest, Esq., General Counsel, Bureau of Internal Revenue, Treasury Department, Washington, D. C.," and posting the same, so addressed and sealed, with postage thereon prepaid, in the United States mail in the City and County of San Francisco, State of California, on the dates hereinafter specified; that there is a regular [405] United States mail service between said City and County of San Francisco and the point to which said envelopes were addressed as aforesaid; that the papers hereinbefore referred to, and the dates upon which the same were mailed, were and are as follows:

Petitioner's proposed consolidated statement of evidence, mailed December 12th, 1931;

Order of the United States Circuit Court of Appeals for the Ninth Circuit, dated November 2d, 1931, enlarging petitioner's time for steps with respect to petition for review, mailed November 2d, 1931; like order of said court, dated December 1st, 1931, mailed December 1st, 1931;

Notice of lodgment of consolidated statement of evidence, and time and place of presentation of same;

Request to present same for approval;

Praecipe for preparation of transcript on appeal, said last three papers having been mailed on the 2d day of January, 1932.

ARTHUR B. DUNNE.

Subscribed and sworn to before me this 2 day of January, 1932.

[Notarial Seal] KATHRYN E. STONE,
Notary Public in and for the City and County of San Francisco, State of California.

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[406] DOCKET Nos. 35,305, 39,157, 43,432.

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

CERTIFICATE OF CLERK U. S. BOARD OF TAX APPEALS TO TRANSCRIPT OF RECORD.

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages 1 to 405, inclusive, contain and are a true copy of the transcript of record, papers and proceedings on file and of record in my office as called for by the praecipe in the appeal (or appeals) as above numbered and entitled.

IN TESTIMONY WHEREOF, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 21 day of March, A. D. 1932.

[Seal] B. D. GAMBLE,
Clerk.

[Endorsed]: No. 6812. United States Circuit Court of Appeals for the Ninth Circuit. Arthur M. Brown, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Arthur M. Brown Petitioner, vs. Commissioner of Internal Revenue, Respondent. Arthur M. Brown, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of Record. Upon Petitions to Review Orders of the United States Board of Tax Appeals.

Filed April 9, 1932.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals for the Ninth Circuit.

No. 6812.

ARTHUR M. BROWN,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

STIPULATION AND ORDER RE PRINTING OF TRANSCRIPT.

The appellant in the above-entitled matter, having presented and filed in this court its transcript of record in the above-entitled matter; and

It appearing that there is certain matter in said transcript that it is unnecessary to reproduce in the printed transcript of record,—

IT IS STIPULATED that the transcript filed in the above-entitled court shall be printed in full except the photostatic copies of the exhibits, being the exhibits which are not set out in appellant's statement of evidence; and

IT IS FURTHER STIPULATED that any of the matter appearing in the said exhibits not to be reproduced in the printed record may be referred to and relied upon by counsel if set out and reproduced in the briefs.

Dated: May 10, 1932.

ARTHUR B. DUNNE,
Attorney for Appellant.
C. M. CHAREST,
Attorney for Commissioner of Internal Revenue.

So ordered.

Dated: ——————————, 1932.

CURTIS D. WILBUR,
Circuit Judge.

[Endorsed]: Filed May 10, 1932. Paul P. O'Brien, Clerk.

In the United States Circuit Court of Appeals for the Ninth Circuit.

No. 6812.

ARTHUR M. BROWN,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

PRAECIPE FOR PRINTING TRANSCRIPT OF RECORD.

To the Clerk of the Above-entitled Court:

The appellant respectfully requests that the transcript of record now on file in the above-entitled matter be printed in accordance with the stipulation of counsel handed you contemporaneously herewith, together with the order of court thereof.

Dated: May 10th, 1932.

ARTHUR B. DUNNE,
Attorney for Appellant.

[Endorsed]: Filed May 10, 1932. Paul P. O'Brien, Clerk.

No. 6812

United States
Circuit Court of Appeals
For the Ninth Circuit

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petitions to Review Orders of the United States Board of Tax Appeals.

PROCEEDINGS HAD IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

At a stated term, to wit, the October Term, A. D. 1932, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City and County of San Francisco, in the State of California, on Monday the twenty-first day of November in the year of our Lord One Thousand Nine Hundred and Thirty-two.

Present: The Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding, Honorable WILLIAM H. SAWTELLE, Circuit Judge, Honorable CHARLES C. CAVANAH, District Judge.

[Title of Cause.]

ORDER OF SUBMISSION.

ORDERED petitions to review in above cause argued by Mr. Arthur B. Dunne, counsel for the petitioner, and by Mr. Wm. Cutler Thompson, Special Assistant to the Attorney General, counsel for respondent, and submitted to the court for consideration and decision.

At a stated term, to wit, the October Term, A. D. 1932, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City and County of San Francisco, in the State of California, on Monday the sixth day of February in the year of our Lord One Thousand Nine Hundred and Thirty-three.

Present: The Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding, Honorable WILLIAM H. SAWTELLE, Circuit Judge, Honorable JULIAN W. MACK, Circuit Judge.

[Title of Cause.]

ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT.

By direction of the court, ORDERED that the typewritten opinion this day rendered by this court in above cause be forthwith filed by the clerk, and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion filed.

[Tile of Court and Cause.]

OPINION OF UNITED STATES CIRCUIT COURT OF APPEALS.

Upon Petitions to Review Orders of the United States Board of Tax Appeals.

Before: WILBUR and SAWTELLE, Circuit Judges, and CAVANAH, District Judge.

CAVANAH, District Judge:

These are three appeals from a decision of the Board of Tax Appeals denying the petitioner a redetermination of alleged deficiencies in his income taxes for the year 1923, 1925, and 1926, in the

respective sums of $17,923.03, $1520.19, and $944.30. The cases were consolidated for hearing and decision before the Board, and are so presented here on a single transcript of record.

The tax involved is the individual, normal income tax and surtax of the petitioner, Arthur M. Brown, for the years thus stated. In 1923 the petitioner was conducting, alone, the business of a general insurance agent, and during the taxable years 1925 and 1926, it was carred on by a partnership composed of him and his son, Arthur M. Brown, Jr., under the name of Edward Brown & Sons.

On June 1, 1902, Edward Brown, Herbert H. Brown, and the petitioner executed a written agreement, by the terms of which they declared their respective interests in the business and then provided:

> "Before any decision of profits is made the said partners mutually agree to pay monthly to Jessie H. Jones, Edith H. Halton, and Ethel Brown (the three daughters of Edward Brown and Sisters of Arthur M. Brown and Herbert H. Brown) the sum of Two Hundred and Fifty Dollars (250) and, Further, that whenever the net income from the business of the said firm shall exceed the sum of Eighteen Thousand Dollars per annum they will pay a one-sixth proportion of such excess to the said Jessie H. Jones, Edith H. Halton, and Ethel Brown."

On May 28, 1907, Edith H. Halton and Ethel Crandell, the two surviving sisters, executed a writ-

ten agreement in which they agreed to accept from the firm $250.00 per month, beginning June 1, 1907, and ending only by mutual agreement, "in full satisfaction of all amounts which may be due, or may become due, to us, or either of us, or to the survivor of us", under the agreement of May 27, 1905, which provides:

> "That any further amounts to which we, or either of us, or the survivor of us, might be entitled from said firm under said agreement shall be retained in the net profits of said firm as the property and to the credit of said Arthur M. Brown and Herbert H. Brown, members of said firm, to be divided between them as they may agree."

In 1923 the petitioner made a payment of $3000.00 to his sister, Edith H. Halton, in accordance with the agreement, and claimed the same as a deduction from business income in his tax return for that year. The deduction was disallowed by the Commissioner on the ground that the payment constituted a capital expenditure.

The surviving daughters of Edward Brown, of whom Edith H. Halton is one, having in the agreement of May 28, 1907, agreed to accept $250.00 per month in satisfaction of all amounts which may become due to them from the firm under the agreement of May 27, 1905, the terms of which are not in the record, and for that reason we are unable to determine what interest, if any, Edith H. Halton had in the business of Edward Brown & Sons, as a partner, or rendered at any time any ser-

vice to petitioner or the firm which would authorize the allowance of the item as a deductible business expenditure within the contemplation of the taxing statute.

The second issue is whether the Board of Tax Appeals adopted the proper method of treating the overriding commissions received by the firm of Edward Brown & Sons during the taxable years in dispute, where it held that petitioner, accounting on the accrual basis, was obliged to report the full amount of the overriding commissions received in the three years in controversy, without deducting, either as a reserve or otherwise, on account of a contingent liability to refund certain portions of such commissions in later years on account of reinsurance or cancellation.

This method adopted by the Board is challenged by petitioner, who asserts that he should be permitted to pay his tax on the basis of earned income computed under the actuarial computation. In other words, that there should be returned as income upon the basis of a *pro rata* apportionment of such commissions to the policy years.

The firm of Edward Brown & Sons acted as general agents for six fire insurance companies during the taxable years in controversy, and the duties required of it were the appointment and removal of local agents; issue, countersign, and cancel policies; adjust losses under policies, receive and receipt for premiums; compute and return premiums on cancelled policies; secure return of premiums on can-

celled reinsurance; receive and acknowledge service of proof of loss; accept service of process; survey all risks offered and accept or reject the same; transfer insurance by endorsement; attend to the payment of all taxes and license fees; and, generally attend to all of the affairs of its principals in the territory in which it operated. All of the policies written by the firm since 1917 are for periods of one, three, or five years, and are subject to cancellation by either the insurance company or the assured. If a policy is cancelled by the insurance company it is obligated to refund a ratable proportion of the premium for the unexpired term of the policy. In the event the assured cancels, the company is entitled to retain the customary short period rate for the time the policy has been in force. Premiums on policies are payable in advance, subject to the usual grace period of sixty days. Remittances are made by the firm to the insurance companies on monthly balances, charging itself a proportional part of any overriding commissions previously received in respect of any business which was cancelled or reinsured in another company, and crediting itself with the overriding commissions due on business written during the month. The books of the firm have been kept on an accrual basis; refunds of overriding commissions on account of cancellations of policies or reinsurance, and of new business, have been accounted as expense and income of the year they occurred. For the first time, at the close of 1923, there appeared on the firm's books a liability account denominated "Return

Commissions". Petitioner in computing business income for the year 1923, claims a deduction of $52,971.96, for the year 1925, $3292.98, and for the year 1926, $1947.77, the amounts credited to the contingent liability account at the close of those years.

It is obvious that the theory of petitioner is that we must anticipate such contingent liability to refund in subsequent years such an amount as the past experience of the business indicates on account of cancellation of policies and reinsurance, in the proportion of the gross commissions earned within the year as the total premiums cancelled during the preceding five-year period bears to the gross premiums written in the same period. To do so, we are required to compute the income of the three years in dispute upon a basis that will reflect the contingencies of the future.

Revenue taxation requires that one who receives a sum of money subject to his disposition should account for the same as income in the year he receives it, and not at some indefinite future time of his own selection. Should the practice urged by petitioner be followed, the collection of the revenues of the National Government would be uncertain, for the Government would be taking the chance that the money is still available for taxation during subsequent years and that the taxpayer is still solvent. Such reserves, as urged by petitioner, to cover contingent liabilities, are not allowable as deductions unless sanctioned by statute, and we do not find any such statute. Spring Canyon Coal Co. v.

Commissioner, 43 F. (2d) 78; Lucas v. American Code Co., 280 U. S. 445; Thomas Cronin Co. v. Lewellyn, 9 F. (2d) 974; Consolidated Tea Co. v. Bowers, 19 F. (2d) 974; Highland Milk Condensing Co. v. Phillips, 34 F. (2d) 777; Earle v. Commissioner of Internal Revenue, 38 F. (2d) 965. This has been the repeated holding of the Board of Tax Appeals. William J. Ostheimer, 1 B. T. A. 18; Uvalde Co., 1 B. T. A. 932; Jackson Casket & Manufacturing Co., 7 B. T. A. 1190; Landesman-Hirschheimer Co., 15 B. T. A. 64; and, Lane Construction Corp., 17 B. T. A. 826, which was affirmed in 49 F. (2d) 1080.

The conclusion we have reached sustains the orders of the Board of Tax Appeals in the three cases.

Orders affirmed.

WILBUR, Circuit Judge, concurring:

In addition to what is said by Judge Cavanah, I wish to add the following statement: As I understand the record the petitioner claimed, and was granted, the right to take from the income of the year 1923 all payments actually made in that year by reason of return of premium on policies written in previous years, and in addition to the allowance upon premiums actually returned during the year 1923 the petitioner set up a reserve of 22.38 per cent of all premiums collected during the year to take care of such return of commission as it was estimated would be required in future years according to the experience of the agency, or, to state the

matter differently, the agent returns as income only 77.62 per cent of the overriding commissions received by him as gross income and deducts therefrom the actual returns of premium made during the year. The total fire overriding commission for 1923 was $236,693.31; and 22.38 per cent thereof was $52,971.58. If this is true it is clear that the petitioner is not entitled to both deductions during the year 1923. If the percentage of 22.38 is reasonable it will make no difference in the long run to the petitioner whether the return commissions due to cancelled policies are deducted from the revenue of the current year or from a contingent fund set up, as petitioner claims the right to do.

[Endorsed]: Opinion and concurring opinion. Filed February 6, 1933. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals
For the Ninth Circuit.

No. 6812

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

and

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

and

ARTHUR M. BROWN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

JUDGMENT.

Upon petition to review an order of the United States Board of Tax Appeals, this cause came on to be heard on the Transcript of the Record from the United States Board of Tax Appeals and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the orders of the said Board of Tax Appeals in this Cause be, and hereby are affirmed.

[Endorsed]: Judgment. Filed and entered February 6, 1933. Paul P. O'Brien, Clerk.

At a stated term, to wit, the October Term, A. D. 1932, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City and County of San Francisco, in the State of California, on Tuesday the twenty-first day of March in the year of our Lord One Thousand Nine Hundred and Thirty-three.

Present: The Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding, Honorable WILLIAM H. SAWTELLE, Circuit Judge, Honorable JULIAN W. MACK, Circuit Judge.

[Title of Cause.]

ORDER DENYING PETITION FOR A REHEARING.

Upon consideration thereof, and by direction of the Court, IT IS ORDERED that the petition of petitioner, filed March 8, 1933, for a rehearing of above cause be, and hereby is denied.

ORDER STAYING MANDATE.

GOOD CAUSE APPEARING THEREFOR, IT IS ORDERED that the mandate in the above-entitled matter be stayed until the application of the petitioner above named to the United States

Supreme Court, for a writ of certiorari, shall have been determined by the denial of the writ, or by final determination in that court if the writ is issued, or until the time to petition therefor shall have expired.

Dated, March 24, 1933.

CURTIS D. WILBUR,
Circuit Judge.

[Endorsed]: Filed March 4, 1933. Paul P. O'Brien, Clerk.

[Tile of Court and Cause.]

CERTIFICATE OF CLERK U. S. CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT TO RECORD CERTIFIED UNDER RULE 38 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITED STATES.

I, Paul P. O'Brien, as clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing two hundred eighty-four (284) pages, numbered from and including 1 to and including 284 to be a full, true and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of counsel for the petitioner and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

ATTEST my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 7th day of June, A. D. 1933.

[Seal] PAUL P. O'BRIEN,
Clerk.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 9, 1933

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted, limited to the question of the deduction on account of reserve.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.